

The copyright of this thesis vests in the author. No quotation from it or information derived from it is to be published without full acknowledgement of the source. The thesis is to be used for private study or non-commercial research purposes only.

Published by the University of Cape Town (UCT) in terms of the non-exclusive license granted to UCT by the author.

**THE COMMONALITIES OR DIVERGENCE OF THE MEANING OF  
BENEFICIAL OWNER IN A TREATY (INTERNATIONAL) AND  
DOMESTIC CONTEXT**

By

Tasneem Koorowlay

(Student Number: KRWTAS001)

SUBMITTED TO THE UNIVERSITY OF CAPE TOWN

in partial fulfilment of the requirements for the degree MCom (Taxation)

Faculty of Commerce

UNIVERSITY OF CAPE TOWN

Date of submission: 25 January 2013

Supervisor: Craig West, Department of Finance and Tax, University of Cape Town

## DECLARATION

I, Tasneem Koorowlay, hereby declare that the work on which this research paper is based is my original work (except where acknowledgements indicate otherwise) and that neither the whole work nor any part of it has been, is being, or is to be submitted for another degree in this or any other university.

I authorise the University to reproduce for the purpose of research either the whole or any portion of the contents in any manner whatsoever.

**Signature:**

Signed by candidate
---------------------

**Date: 25 January 2013**

University of Cape Town

## **ACKNOWLEDGEMENTS**

My sincere gratitude is extended to Professor Peter Surtees and to my supervisor, Professor Craig West, for their encouragement, helpful comments and indispensable technical suggestions during the completion of this dissertation. My work has benefited greatly from their guidance.

I am also grateful to my employer, Old Mutual, for encouraging and enabling me to undertake this course. In particular, I wish to thank the Head of Tax at Old Mutual, Gary Eaves for his encouragement in completing this course.

**Tasneem Koorowlay**

**Cape Town**

**25 January 2013**

University of Cape Town

## **ABSTRACT**

The aim of this dissertation is to establish the relevance of the international interpretation of beneficial owner to SA's interpretation of the concept. The phrase "beneficial owner" was introduced into the South African Income Tax Act in April 2012 following an intention to align South African tax as regards dividends with international norms. The concept is applied in a domestic context by various countries and in numerous bilateral tax treaties and has been a subject of debate across numerous foreign courts. However, a commonly accepted interpretation in South Africa or in the international arena remains elusive.

This dissertation examines "beneficial owner" in the domestic legislation of selected countries and assesses the development of the concept in international conventions like the OECD and UN Models as well as the outcomes of four key foreign judgments. The conclusions drawn from the above analysis were applied to the South African use of "beneficial owner" in the domestic legislation and selected bilateral tax treaties concluded by South Africa with another country. Despite the absence of a commonly accepted interpretation, this study established that "beneficial owner" appears to have common aspects in the interpretation of the concept in SA as well as in international spheres. Given this conclusion, an international interpretation of be beneficial owner would be valuable to South Africa's use of the term in Income Tax Legislation.

## ABBREVIATIONS AND GLOSSARY

UN	United Nations
OECD	Organisation for Economic Co-operative Development
STC	Secondary Tax on Companies
DT	Dividends Tax
SA	South Africa
DTA	Double Tax Agreement (used interchangeably with treaty)
UK	United Kingdom
USA	United States of America
BRIC	Brazil, Russia, India and China
BRICS	Brazil, Russia, India, China and South Africa
HMRC	Her Majesty's Revenue & Customs
ITA	Income Tax Act

## TABLE OF CONTENTS

<b>CHAPTER 1: INTRODUCTION, BACKGROUND AND DEMARCATION OF THE STUDY .....</b>	<b>1</b>
1.1 INTRODUCTION .....	1
1.2 PURPOSE OF THE RESEARCH .....	1
1.3 RESEARCH METHOD .....	3
1.4 DELINEATION AND LIMITATIONS .....	3
1.5 CHAPTER OVERVIEW .....	4
1.6 CONCLUSION.....	6
<b>CHAPTER 2: BENEFICIAL OWNER IN DOMESTIC LAW .....</b>	<b>7</b>
2.1 INTRODUCTION .....	7
2.2 LEGAL SYSTEMS IN RELATION TO BENEFICIAL OWNER .....	7
2.3 THE RELEVANCE OF DOMESTIC LAW TO BENEFICIAL OWNER .....	8
2.4 UNITED KINGDOM .....	10
2.5 UNITED STATES OF AMERICA .....	12
2.6 CANADA .....	14
2.7 BRAZIL .....	16
2.8 RUSSIA .....	17
2.9 INDIA .....	18
2.10 CHINA .....	20
2.11 CONCLUSION .....	22
<b>CHAPTER 3: BENEFICIAL OWNER IN THE OECD AND UN MODELS .....</b>	<b>26</b>
3.1 INTRODUCTION .....	26
3.2 BENEFICIAL OWNERSHIP IN THE OECD AND UN MODELS .....	27
3.3 CONCLUSION.....	35
<b>CHAPTER 4: BENEFICIAL OWNER IN INTERNATIONAL COURTS.....</b>	<b>37</b>
4.1 INTRODUCTION .....	37
4.2 SIGNIFICANT OUTCOMES OF INDOFOOD.....	37
4.3 SIGNIFICANT OUTCOMES OF PREVOST .....	41
4.4 SIGNIFICANT OUTCOMES OF VELCRO.....	45
4.5 SIGNIFICANT OUTCOMES OF A/AS .....	47
4.6 OBSERVATIONS.....	48
4.7 CONCLUSION .....	54
<b>CHAPTER 5: BENEFICIAL OWNER FROM A SOUTH AFRICAN PERSPECTIVE .....</b>	<b>55</b>
5.1 INTRODUCTION .....	55
5.2 RELEVANCE OF SOUTH AFRICAN LEGAL SYSTEM.....	55

5.3	ORDINARY MEANING GIVEN TO BENEFICIAL OWNER IN SA.....	56
5.4	BENEFICIAL OWNER IN THE DOMESTIC LAW OF SA .....	57
5.5	BENEFICIAL OWNER IN SOUTH AFRICAN TREATIES .....	60
5.6	THE IMPACT OF AN INTERNATIONAL INTERPRETATION TO SA .....	64
5.7	CONCLUSION .....	66
<b>CHAPTER 6 CONCLUSION.....</b>		<b>68</b>
6.1	INTRODUCTION .....	68
6.2	BENEFICIAL OWNER IN DOMESTIC LAW .....	68
6.3	BENEFICIAL OWNER IN THE OECD AND UN MODELS .....	69
6.4	BENEFICIAL OWNER IN INTERNATIONAL CASE LAW .....	70
6.5	BENEFICIAL OWNER FROM A SOUTH AFRICAN PERSPECTIVE.....	70
6.6	GENERAL.....	71
<b>BIBLIOGRAPHY .....</b>		<b>72</b>
CASE LAW .....		72
BOOKS.....		72
DISSERTATION.....		72
INTERNATIONAL CONVENTIONS.....		72
ARTICLES .....		73
SOUTH AFRICAN GOVERNMENT PUBLICATIONS AND LEGISLATION.....		74
SOUTH AFRICAN TREATIES .....		74
ELECTRONIC RESOURCES .....		74



## **CHAPTER 1: INTRODUCTION, BACKGROUND AND DEMARCATION OF THE STUDY**

### **1.1 INTRODUCTION**

The concept of beneficial owner has proven to be quite topical, both internationally and in South Africa (“SA”) due to its interpretive and evolutionary nature. The concept is found in the domestic legislation of other countries, is debated in foreign courts, is translated into different languages of various countries, and is present in numerous Double Tax Agreements (“DTAs”) and international conventions like the Organisation for Economic Co-operative Development (“OECD”) and the United Nations (“UN”) Models.

Beneficial owner is also a popular treaty concept, yet it has not been formally defined in any treaty or international convention. It has been a subject of much debate, particularly whether it should be interpreted with reference to an international fiscal meaning or should rather be subject to the domestic interpretation of the relevant country in a treaty context. The terms “beneficial owner” and “beneficial ownership” are used interchangeably in this dissertation or are referred to as “the concept”.

In SA, the phrase “beneficial owner” was introduced in the enactment of the legislative provisions pertaining to a tax on dividends. The intention behind enacting the Dividends Tax (“DT”) legislation into the Income Tax Act (“ITA”) was to align South African tax in relation to dividends with international norms. Pursuant to this objective, this dissertation examines beneficial owner as it has developed in the international tax arena and resolves to establish its relevance to the interpretation in South African Income Tax legislation.

### **1.2 PURPOSE OF THE RESEARCH**

The objective of this dissertation is to examine and draw out the commonalities or divergences in interpretation of beneficial owner in a treaty (international) and domestic context. The commonalities or differences identified will be assessed for similar factors present in the domestic use of the concept within South African DT legislation. The research aims to draw attention to and interpret the concept in the domestic law of SA which is ambiguous or difficult to understand and where possible draw on international interpretation.

The interpretation of beneficial owner from an international perspective will encompass the domestic law of other countries, international conventions and international case law. The scope of this dissertation will specifically examine the concept's use in the domestic legislation of selected developed and developing countries; assess the development of the concept in international conventions like the OECD and UN Models; and examine the outcomes of four key international cases addressing this issue. Before such analysis is done, it is first necessary to contextualise the relevance of international meanings to South African law.

Beneficial owner was introduced into the ITA as a result of the enactment of the DT legislation where one of the main objectives is to align the domestic law of SA, in respect of the taxation of dividends, with international norms. Beneficial owner is briefly defined in the DT legislation, however, there is no interpretation note supporting that definition. Also beneficial owner is contained in numerous tax treaties concluded by SA with other countries, yet the concept is not defined in any of those treaties.

Beneficial owner arose as a trust law concept in the common law of the United Kingdom ("UK"). The concept is also contained in several provisions of the domestic legislation of the developed economies of UK, United States of America ("USA") and Canada (Refer Chapter 2). As a result, these countries would have had an interpretation of the concept at the time it was introduced into their domestic laws. Hence, these countries would be a good starting point to investigate the meaning of the concept and where necessary draw on their interpretation.

BRIC is an economic forum for developing countries of Brazil, Russia, India and China which SA joined in 2010 to form the BRICS nations (Global Sherpa, 2012). With the exception of India, beneficial owner is also relatively new in the domestic laws of the selected developing economies. Therefore it would be useful for SA to compare their interpretation of the concept with its peers.

The concept was also first introduced into international fiscal usage through works of the OECD in a treaty context and therefore international conventions like the OECD and UN Models would be a good source from which to draw meaning. Furthermore, international case law is relevant to the study because these decisions have persuasive value in South

African courts and therefore may add value to SA's interpretation of beneficial owner (Refer 5.6.3).

### **1.3 RESEARCH METHOD**

Non-empirical research methods are the most appropriate method to address the impact of an international interpretation on SA's use of the concept of beneficial ownership in its domestic legislation. The particular method employed is that of expository research which includes a review of literature and analysis of government publications, court cases, international conventions and published articles to establish a common meaning to beneficial owner.

As the study is not limited to SA, the research with regard to beneficial owner will include international articles, international conventions and international case law which will be accessible via the internet and provide valuable input into the research.

Due to the fact that the concept of beneficial owner is more of a technical interpretation, an empirical study will not be appropriate as the observations obtained via quantitative or qualitative sampling will not influence the interpretation and technical nature of the concept.

### **1.4 DELINEATION AND LIMITATIONS**

This study includes a few limitations due to the fact that beneficial owner has been a developing concept in the world and is a more recent concept in SA's legislation. This dissertation only deals with the interpretation of beneficial owner in the context of South Africa and the domestic legislation of the selected countries outlined in 1.2.

The interpretation of the concept in international conventions of the OECD and UN Models is limited to the Commentaries of the Dividend Article 10. This study does not give an account of any other international conventions that are currently in effect.

The outcomes outlined in respect of international case law are limited to the four cases examined in Chapter 5 in respect of beneficial owner. Due to the limitations outlined above, the interpretations drawn would not necessarily be a conclusive account of all interpretations that are available in SA and internationally.

## **1.5 CHAPTER OVERVIEW**

### **CHAPTER 1: INTRODUCTION, BACKGROUND AND DEMARCATION OF THE STUDY**

This chapter introduces the research topic and highlights the issues to be explored. It also sets out what objectives the dissertation aims to achieve within the boundaries of its scope. Through achieving these objectives, the academic value and practical relevance that may be obtained from this dissertation is outlined in the chapters that follow.

### **CHAPTER 2: BENEFICIAL OWNER IN DOMESTIC LEGISLATION**

Beneficial owner arose as a common law concept in the domestic laws of the UK. This chapter analyses the concept of beneficial owner in the domestic laws of the developed economies of the UK, USA and Canada as well as the developing economies of BRIC. Focus will be placed on the following elements in respect of each country with regard to beneficial owner:

- The ordinary meaning of the concept.
- The use of the concept in the tax legislation.
- The usage of the concept in local case law.
- The impact of the use in multi-lingual countries.

### **CHAPTER 3: BENEFICIAL OWNER IN THE OECD AND UN MODELS**

This chapter examines how beneficial owner has developed in the Commentaries to Article 10 of the OECD and UN Models. The OECD and UN Models provide a treaty framework for developed and developing economies respectively. The UN Model is largely a derivation of the OECD Model. Beneficial owner is not defined in the OECD and UN Models and is a concept contained in numerous treaties world-wide which also do not define the concept. The lack of definition and the world-wide wide usage of the concept results in a flexible interpretation across contracting parties to a common treaty. The flexible interpretation stems from the fact that contracting parties to a treaty are usually from different countries that use different languages, interpretation methods as well as different legal systems that are practiced within their respective countries. As a result of the vulnerability to a flexible interpretation, the OECD has released proposed amendments to the Commentaries of Article 10 in respect of the concept. This chapter places particular focus on the amendments

proposed by the OECD in 2011 and its revised proposals of 2012 regarding the interpretation of beneficial owner.

#### **CHAPTER 4: BENEFICIAL OWNER IN INTERNATIONAL CASE LAW**

There has been a consistent debate in varying courts across the world with regard to identifying or interpreting a beneficial owner in recent years. The four international cases below have been selected for investigation due to the contributory factors it may have to the domestic interpretation of the concept in SA. The four cases selected are:

- Indofood International Finance Ltd v. JP Morgan Chase Bank NA Court of Appeal, 2nd March 2006, (2006) 8 ITLR 653; [2006] STC 1195 (“Indofood”).
- Prevost Car Inc v R 2008 TCC 231, affirmed by the Federal Court of Appeal in 2009 FCA 57 (“Prevost”).
- Velcro Canada Inc v Her Majesty the Queen, 2012 TCC 57, 24 February 2012 (“Velcro”).
- A-6537/2010 of Mar. 7, 2012 (“A/AS”).

The decision of Indofood was pronounced in the UK where beneficial owner finds its basis in the common law. Baker, in his analysis of Indofood stated that the concept should be accorded with an international fiscal meaning (Baker, 2007:P2). Prevost and Velcro were recent judgements where both decisions were pronounced in the courts of Canada. Certain territories of Canada operate under either civil law or common law systems which is relevant to this study and is likely to contribute towards a meaning of beneficial owner. The decision of A/AS was pronounced in 2012 in a civil law court of Switzerland. This case would make an interesting contrast to beneficial owner that arose as a common law concept in the tax system.

#### **CHAPTER 5: BENEFICIAL OWNER FROM A SOUTH AFRICAN PERSPECTIVE**

The purpose of this chapter is to examine the interpretation of beneficial owner from a South African perspective and establish the relevance of an international meaning on SA’s domestic use of the concept in Income Tax legislation. Beneficial owner was introduced into the South African DT legislation in April 2012 following the repeal of the Secondary Tax on Companies (“STC”) legislation. The definition of beneficial owner in the DT legislation is quite wide and there is no interpretation note assisting the interpretation of the concept.

Beneficial owner is also contained in numerous bilateral tax treaties that SA concluded with other countries which do not contain a definition. The lack of definition as well as a world-wide usage of the concept, results in conflicting interpretations. In support of the intent to align with international tax systems, it would be beneficial for SA to draw on the interpretation accorded to beneficial owner in international tax spheres.

## **CHAPTER 6: CONCLUSION**

The final chapter summarises the results of the research and provides concluding remarks regarding the interpretation of beneficial owner.

### **1.6 CONCLUSION**

The focus of this chapter is to provide an overall summary of the research topic, setting out the research method used to achieve the objectives of the dissertation. It further details the value it may bring to the various persons and bodies of society and any limits on the application of the findings of this research.

## CHAPTER 2: BENEFICIAL OWNER IN DOMESTIC LAW

### 2.1 INTRODUCTION

This chapter analyses the interpretation of beneficial owner in the domestic law of the selected countries outlined below. The analysis will be useful to assess various domestic law aspects for commonality and may contribute to finding a clear meaning for beneficial ownership in the recently enacted DT legislation (discussed in Chapter 5). The extent to which differences arise or similar interpretations are used may also add to the debate as to whether the domestic law interpretation or international interpretation should apply in a treaty and possibly a domestic context (for South Africa).

The study of the domestic legislation of the following developed countries: UK, USA and Canada are included under subsections 2.4 to 2.6. This is followed by a study of the developing countries of Brazil, Russia, India and China under subsection 2.7 to 2.10. The study of domestic law includes a combination of the following in respect of the selected countries in this chapter:

- Ordinary meaning given to beneficial owner.
- Use of beneficial owner in the provisions of domestic acts or circulars.
- Case law that discussed beneficial owner.

A prelude to the study of countries is included under 2.2 and 2.3 of this chapter which includes a brief review on the background of common law and civil law systems in relation to beneficial owner as well as the relevance of domestic law to the concept.

### 2.2 LEGAL SYSTEMS IN RELATION TO BENEFICIAL OWNER

There are many legal systems in the world today and each country's system is shaped by its unique history and therefore incorporates individual variations of law (Hertel, 2009:P128). Generally, the most common basis for legal systems across various countries in the world is common law and civil law systems or a combination of the two systems (Hertel, 2009:P128).

Beneficial ownership is a trust law concept which originated in England in the Court of Chancery and is therefore a derivation of common law (Du Toit, 1999:P57). Common law

originated<sup>1</sup> in the UK and applied to countries that were formerly (or are still) governed by the UK, in particular the Commonwealth countries and the USA where English is the official language of the respective country (Hertel, 2009:P129). The doctrine of common law, in relation to beneficial owner, gave rise to the distinction between equitable (beneficial) ownership and legal ownership, where equity would allow the use and benefit of property (or income) to be held separately from the legal ownership (HRMC, 2012).

Consequently, countries that apply the common law systems are important in assessing whether beneficial owner should be given a meaning in terms of domestic law or should be accorded with a common international meaning. Despite its origin in common law countries, beneficial owner has also evolved into the domestic law of civil law countries such as Brazil, Russia and China in the last decade. In contrast to countries that apply common law, civil law jurisdictions rely on their enacted codified law and do not apply the same principles as common law (Hertel, 2009:P129).

It is important to note the difference between the two legal systems because such difference in the application of law may influence the interpretation of beneficial owner. Particular emphasis is also placed on the origin of the legal system in relation to the country and the language of such country. Such emphasis gives prominence to the possible meaning intended to apply to beneficial owner and also indicates the possible disparity between English and other languages.

## **2.3 THE RELEVANCE OF DOMESTIC LAW TO BENEFICIAL OWNER**

### **2.3.1 RELEVANCE OF DOMESTIC LAWS OF DEVELOPED COUNTRIES TO BENEFICIAL OWNER**

Beneficial owner arose as a common law concept in the UK jurisdiction. The concept was also formalised into the OECD Model in 1977 following its usage in a treaty between the UK and the USA (Collier, 2011:P686). Both countries are developed nations from an economic perspective and are also important precursors to international tax law. Consequently, the interpretation of the concept may strongly derive meaning ascribed to it from the domestic legislation of these countries.

---

<sup>1</sup> Common law is documented to originate in the Early Middle Ages in 1066 (Britannica, 2012)



Canada is also a developed country where the legislation is largely based on common law practices with the exception of Quebec that operates under a civil law system (Department of Justice Canada, 2012).

In addition, important case law (refer Chapter 4) regarding beneficial owner has emerged from the judiciary in Canada which makes it relevant to testing the domestic meaning of the concept and is therefore also selected as a country for research in this chapter.

### **2.3.2 RELEVANCE OF DOMESTIC LAWS OF DEVELOPING COUNTRIES TO BENEFICIAL OWNER**

The BRIC countries are the emerging markets in the international arena that are developing into the future influential economies in the world (Global Sherpa, 2012). Brazil, Russia, India and China were first named as the BRIC countries in 2001 by Jim O' Neill, Chairman of Goldman Sachs Asset Management (Goldman Sachs, 2012). Since then SA has also emerged as an influential economy from a growth perspective and has been invited to join the BRIC countries in December 2010, now called the BRICS nations.

Brazil, Russia and China are regulated largely by the civil law system where in contrast India is governed predominantly by common law. Beneficial owner is currently topical in Brazil, Russia and China. The concept is either receiving deliberations before promulgation or has been recently adopted into domestic legislation of the respective countries.

From an Indian perspective, beneficial owner is a fairly well known concept and is included in various legislative measures that are in effect in the domestic legislation of India (Singh & Kataria, 2012:P137).

The relevance of SA and its domestic legislation to beneficial owner will be addressed in Chapter 5 and will not be included as a subset of this chapter under the study of the BRICS nations. Apart from India, beneficial owner is an emergent or developing concept in the domestic legislation of the BRICS nations and therefore it is integral to the study of beneficial owner from the perspective of domestic law.

## 2.4 UNITED KINGDOM

Beneficial ownership is a trust law concept that originated in the UK and therefore plays a very important role in ascribing a meaning to beneficial owner. The concept is not confined to a trust scenario because it is used in numerous treaties as well as international conventions like the OECD and UN Models. Beneficial owner appears in numerous provisions of the UK tax law and consequently also appears in numerous tax cases, three of which are referred to under 2.4.3 where the judiciary attempted to ascribe a meaning to the concept.

### 2.4.1 ORDINARY MEANING GIVEN TO BENEFICIAL OWNER

The ordinary meaning given to beneficial owner distinguishes between legal owner and beneficial owner. The beneficial owner is essentially the recipient that enjoys the benefits of ownership whereas the legal owner is the recipient who is regarded as the owner in terms of legislation. Black's Law Dictionary (as quoted by Singh & Kataria (2012:P133)) defines beneficial owner and legal owner as follows:

- *“Beneficial owner: ‘One recognized in equity as the owner of something because use and title belong to that person, even though legal title may belong to someone else; esp. one for whom property is held in trust.’”*
- *“Legal owner: ‘one recognized by law as the owner of something; esp., one who holds legal title to property for the benefit of another.’”*

### 2.4.2 DEFINITION OF BENEFICIAL OWNER IN THE INCOME TAX ACT OF 2007 IN THE UNITED KINGDOM (“UK ITA”)

Beneficial owner is not defined in the UK ITA, although it is contained in numerous provisions. Section 351, for example, contains the phrase “beneficial ownership” in the context of an investor that earns passive income in relation to an investment or investment loan:

***“Investor must have beneficial ownership***

- (1) The investor must be the sole beneficial owner of the investment when it is made.*
- (2) If the investment consists of a loan, the person beneficially entitled to repayment of the loan is treated as the beneficial owner of the loan for the purposes of this Part.”*

This provision does not provide a definition of the concept. Subsection 1 indicates that an investor should be the sole owner of an investment possibly combining the legal owner with

the beneficial owner of the investment. However if the investment is a loan, subsection 2 indicates that an investor would qualify as the beneficial owner only if such investor is beneficially entitled to the repayment of the loan. The implication that may be drawn from this section is that there is only one owner of the investment which would therefore qualify as the beneficial owner. The Explanatory Note 996 to S351 of the UK ITA supports subsection 1 and 2 by indicating that the investor must be the sole beneficial owner of the investment (Legislation.gov.uk, 2012).

### **2.4.3 ENGLISH CASE LAW THAT ASCRIBES A MEANING TO BENEFICIAL OWNER**

Du Toit (1999: P57) indicates that the most commonly cited meaning of beneficial ownership from an English Court is that by Lord Diplock in *Ayerst (Inspector of Taxes) v. C&K (Construction) Ltd*:

*“My lords, the concept of legal ownership of property, which did not carry with it the right of the owner to enjoy the fruits of it or dispose of it for his own benefit, owed its origin to the Court of Chancery. The archetype is the trust. The ‘legal ownership’ of the trust property is in the trustee, but he holds it not for his own benefit but for the benefit of the cestui que trust or beneficiaries. On the creation of a trust in the strict sense as it was developed by equity the full ownership in the trust property was split into two constituent elements, which became vested in different persons: the ‘legal ownership’ in the trustee, and what came to be called the ‘beneficial ownership’ in the cestui que trust”.*

According to Lord Diplock, the ownership of property in a trust is split between the legal owner who is the trustee and the economic owner who enjoys the benefits associated with the property. This scenario is indicative of a common law interpretation that allows for division of ownership between the legal owner and the economic owner in relation to property in a trust. This meaning appears to support the substance over form doctrine where the concept is intended to be interpreted based on the facts of the case at hand, rather than the legal representations of the case.

The above case was a domestic dispute, however the expression “the right of the owner to enjoy the fruits of it or dispose of it for his own benefit” is similar to the expression used by the OECD in the 2012 proposed amendments to the interpretation of beneficial owner (refer

3.2.9). This expression also coincides to some extent with certain elements of the definition attempted by Justice Rip in the treaty case involving Prevost (refer 4.3.5).

*“In Wood Preservation Ltd v. Prior (Inspector of Taxes), Lord Donovan declined to give a meaning to beneficial owner, holding that it would be rash to attempt an exhaustive definition of beneficial ownership. His colleague, Harman L.J., though, was less reserved, holding beneficial ownership to mean:*

*‘An ownership which is not merely the legal ownership by the mere fact of being on the register but the right at least to some extent to deal with the property as your own ’” (HMRC, 2012).*

Lord Donovan in the Wood case supports the meaning accorded to beneficial owner by Lord Diplock in the Ayerst case. This case indicates that the concept should be interpreted with reference to a right to deal with the property as your own as opposed to mere legal ownership of the property.

In *J Sainsbury plc v. O'Connor (Inspector of Taxes)*, Nourse L.J. said the following:

*“It means ownership for your own benefit as opposed to ownership as trustee for another” (HMRC, 2012).*

The Sainsbury case is another illustration where the interpretation of beneficial owner is given a focus on rights of ownership rather than legal ownership.

There is evidently a strong presence of rights to ownership in UK case law. In addition, when determining the beneficial owner, due regard is given to the person that derives the benefit or enjoys the “fruit” of the property as opposed to the person who holds the legal title of the property.

## **2.5 UNITED STATES OF AMERICA**

Beneficial ownership is also a term well known in the USA and is recognised in US statutes, such as Commerce and Trade, Banks Act, Internal Revenue Customs as well as Treasury Regulations (Du Toit, 1999:P67). Like the UK, there appears to be a focus on the substance over form doctrine in the USA. The focus appears to be on looking into the economic realities of the matter rather than relying on the legal form of a factual situation.

### **2.5.1 BENEFICIAL OWNER IN THE INTERNAL REVENUE CODE OF THE UNITED STATES OF AMERICA (“IRC”)**

The IRC does not include a definition of beneficial owner. Subsection 674 of Section 26 of the IRC has been extracted in relation to a trust which contains an expression “beneficial enjoyment” which is closest to the concept of beneficial ownership:

*“The grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party”* (Legal information Institute, 2012).

The provision from the IRC is not directly related to dividend income. The provision is in relation to an income which indicates that the grantor who is the recipient of the income must be treated as the owner of the income if the recipient has the beneficial enjoyment of such income. Also the enjoyment of such income does not require the consent of any adverse party. The expressions “beneficial enjoyment” and “*without the approval or consent of any adverse party*” applies the substance of matter over legal form doctrine. The former expression looks into the identity of the economic owner of the income. The expression “*without the approval or consent of any adverse party*” supports the expression “beneficial enjoyment” by implying that the recipient of the income has a right to the income without the required consent of any other party. This coincides with the proposed amendments made by the OECD in respect of beneficial owner (Refer 3.2.9).

### **2.5.2 UNITED STATES CASE LAW THAT ASCRIBES A MEANING TO BENEFICIAL OWNER**

The Montana case below identifies some criteria to determine beneficial owner which does find support with the criteria of “rights in relation to property or income” as identified in the UK.

In the Supreme Court, *Montana Catholic Missions v Missoula County*, Mr Justice Peckham held as follows:

*“The expression beneficial use or beneficial ownership or interest in property is quite frequent in the law and means, in this connection, such a right to its enjoyment as exists where the legal title is in one person and the right to such beneficial use or interest is in*

*another, and where such right is recognized by law, and can be enforced by the courts, at the suit of such owner or of someone in his behalf”* (Legal Information Institute, 2012).

The above case was a domestic dispute where the interpretation of the above extract implies that beneficial owner is the recipient that has a right to the enjoyment of the property which may be separate from the person that holds the legal title to the property. The expression “the right to its enjoyment” contains elements of the expression used by the OECD in the 2012 proposed amendments to the interpretation of beneficial owner (refer 3.2.9). This expression also coincides to some extent with certain elements of the definition attempted by Justice Rip in the treaty case involving Prevost which set a precedent in the Velcro case (refer 4.3.5).

The following case of *Cepeda, Eduardo, et ux. v. Commissioner* focuses on the economic benefits associated with the command of property which is akin to applying the substance over form doctrine.

*“Parr J. explained as follows: ‘In applying this doctrine of substance over form, the Court has looked to the objective economic realities of a transaction rather than to the particular form the parties employed. ...*

*A similar analysis of control and command over property as that which determines economic benefit is present in a substance over form determination’”* (Du Toit, 1999:P70).

The focus of the expression “economic realities of a transaction rather than to the particular form the parties employed” in the above dispute is similar to the principles applied in Indofood which was discussed in a treaty context (Refer Chapter 4).

## **2.6 CANADA**

Beneficial ownership is a recognised term in the domestic legislation of Canada. English and French are Canada’s official languages and both languages have equal status, equal rights and privileges in Parliament and the Government of Canada (Department of Justice Canada, 2012). In view of the fact that English and French languages are equally authoritative in Canada, beneficial owner should be equally understood in both languages. Beneficial owner is also well known in the case law of Canada where two recent treaty cases (Prevost and Velcro) focuses on the meaning of beneficial ownership which is discussed in Chapter 4.

### **2.6.1 BENEFICIAL OWNER IN THE CANADIAN INCOME TAX ACT (“CITA”)**

Although CITA contains beneficial owner as part of a provision, it does not include a definition of the concept. An example of an inclusion of the concept in a provision is Section 248 (1) under section (e) of the CITA which reads:

*“(e) any transfer of the property as a consequence of which there is no change in the beneficial ownership of the property”*

This provision does not assist in obtaining a meaning of beneficial owner. It is likely that the concept was included in the provision of CITA with the understanding that the concept is universally understood by users of the legislation.

The Canada Revenue Agency issued an Interpretation note IT437 which contain the following extract with regard to beneficial owner:

*“The term ‘beneficial ownership’ is used to describe the type of ownership of a person who is entitled to the use and benefit of the property whether or not that person has concurrent legal ownership. A person who has beneficial ownership rights but not legal ownership can enforce those rights against the holder of the legal title”* (Canada Revenue Agency, 2013).

The above is another interpretation that reaffirms the substance over form doctrine. The Interpretation note focuses on the recipient who is entitled to the use or benefit of the property rather than the person who legally owns the property. This coincides with the principles applied in Indofood which was discussed in a treaty context (Refer Chapter 4).

### **2.6.2 CANADIAN CASE LAW THAT ASCRIBES A MEANING TO BENEFICIAL OWNER**

The case of *Fortin & Moreau Inc. c. Ministre du Revenu National* provides a description for beneficial owner as follows:

*“beneficial owner of property as the one to whom ownership belongs subsequent to a transaction (when the purchaser has all incidents of title, such as possession, use and risk, although legal title may remain in the vendor as security), but who will receive title to the property at a later date”* (Du Toit, 1999:P75).

The expressions “possession”, “use” and “risk” was motivated in the above case in an attempt to describe beneficial owner in relation to the purchaser of the property. Accordingly, there

must be an element of ownership in the meaning ascribed to beneficial owner which is not necessarily limited to the recipient that has legal title of the property.

The above case was a dispute in the domestic law of Canada. However the principles identified in the above case appear in the treaty cases of Prevost and Velcro where the courts attempted to ascribe a meaning to beneficial owner (Refer 4.3 and 4.4).

## **2.7 BRAZIL**

Brazil's legal system is typically a civil law system deriving its basis from Portuguese civil law (Rocha, 2012:P1). Beneficial ownership, translated in Portuguese "*beneficiario efetivo*", has been introduced into Brazilian domestic law as recent as 2008 following the enactment of Law 12249/2010 (Rocha, 2012:P1). Although Brazil's legal system recognises some forms of fiduciary ownership, it does not recognise the separation of property rights between legal ownership and beneficial ownership, which is typically found in common law systems. Beneficial owner is relatively new in Brazil's legislation and therefore there is not much case law in relation to the concept.

### **2.7.1 LANGUAGE: TRANSLATION OF "BENEFICIARIO EFETIVO" INTO BENEFICIAL OWNER**

A direct translation in English of the above Portuguese expression is "actual beneficiary" (Linguee, 2012). The English translation of the Brazilian version of beneficial owner appears to be a close permutation to the concept. This is however an interpretive view of the concept which may not apply in a practical situation.

### **2.7.2 BENEFICIAL OWNER IN BRAZIL'S INCOME TAX LEGISLATION: LAW 12249/2010**

According to the 2008 legislation the beneficial owner shall be regarded as:

*"individual or legal entity not constituted with the sole or main objective of achieving a tax saving, who receives these amounts for his own account and not as agent, trustee or nominee on behalf of a third party"* (Rocha, 2012:P1).

The domestic legislation has defined beneficial owner as the individual or legal entity who enters into a transaction which has economic purposes that transcends the possibility of



entering into a tax avoidance or evasion scheme. Furthermore an agent, trustee or nominee is precluded from qualifying as a beneficial owner.

The meaning accorded to beneficial owner in Brazil's Income Tax legislation draws from the interpretation given to the concept in Paragraph 12.2 to the Commentary of Article 10 of the OECD Model (Rocha, 2012:P8). Given the similarities between the interpretation of beneficial owner in the domestic laws of Brazil and the OECD Model, it is maintained that Brazil is inclined to base this term in their legislation on an international premise.

## **2.8 RUSSIA**

In May 2009, the Russian legislature considered introducing an expression, “actual recipient” which is a variation of beneficial owner into its domestic legislation (Taxand, 2010). The purpose of the concept was part of a wider initiative to address anti-abuse measures in the field of Russian taxation (Taxand, 2010). In May 2012, the Federal Tax Service (“FTS”) of Russia proposed to introduce the concept of “ultimate beneficiary” into its legislation which is also intended to correspond to the concept of beneficial owner (tkzattorneys, 2012).

Beneficial owner is quite a controversial subject in Russia because the concept is still in its initial stages of development and has not been enacted by its law. Consequently, there is not much case law available that would provide meaning to the concept. Russia is also regulated by a civil law system where legislation relies on the enacted Civil Code of the Russian Federation (Clifford Chance, 2012).

### **2.8.1 BENEFICIAL OWNER IN RUSSIA'S INCOME TAX LEGISLATION**

The definition proposed by the FTS for “ultimate beneficiary” which is intended to correspond to beneficial owner reads:

- *“An individual or a legal entity that is a direct (or an indirect (through a participation in other companies or otherwise)) recipient of income of an entity and has the right to own, use and dispose of such income (i.e. an actual right to determine the economic destiny of such income); or*
- *A person in whose interests another person is authorized to use and (or) dispose of such income”* (tkzattorneys, 2012).

The definition proposed directs the recipient of the income to have a right to own, use and dispose of the income. The definition refers to the expressions “actual right” and “economic destiny of such income” in relation to the recipient of the income which appears to share commonalities with the substance over form doctrine. The substance over form doctrine in relation to beneficial owner is typically practiced in common law jurisdictions which do not necessarily apply in Russia’s civil law. This doctrine was also used in the judicial decisions of Indofood, Prevost and Velcro in determining the meaning of beneficial owner in a treaty context (refer Chapter 4). Like the OECD, Russian law also introduced beneficial owner into its legislation as an anti-avoidance measure in the field of taxation which coincides with the principles of the OECD in relation to the concept (Refer 3.2.7.3).

## **2.9 INDIA**

Beneficial owner is a recognised concept in the Indian Income Tax Act of 1961. Beneficial ownership is not reproduced in the traditional Hindi language of India and therefore has not been translated from Hindi to English and vice versa (Du Toit, 1999:P99).

### **2.9.1 DEFINITION OF BENEFICIAL OWNER IN THE INDIAN INCOME TAX ACT OF 1961 (“IITA”)**

Various provisions of the IITA recognise the concept of beneficial ownership. However the legislation does not provide a definition to the concept. Beneficial owner as recognised in two selected provisions of the IITA provide:

Section 45(2A) reads: *“Where any person has had at any time during the previous year any beneficial interest in any securities, then, any profits or gains arising from transfer made by the depository or participant of such beneficial interest in respect of securities shall be chargeable to income-tax as the income of the beneficial owner of the previous year in which such transfer took place and shall not be regarded as income of the depository who is deemed to be the registered owner”* (Vakil No 1.com, 2012).

Section 45(2A) is in relation to capital gains on the sale of securities. The sale of securities held in dematerialized form creates a liability in the hands of the beneficial owner of the securities and not the recipient deemed to be the legal owner of the securities (Singh & Kataria, 2012, P137). This provision essentially deems any profits or gains to accrue to the beneficial owner rather than the legal owner and therefore this provision places reliance on

the economic substance of the respective transaction rather than the legal representation of such transaction.

Section 94(2) reads: *Where any person has had at any time during any previous year any beneficial interest in any securities, and the result of any transaction relating to such securities or the income thereof is that, in respect of such securities within such year, either no income is received by him or the income received by him is less than the sum to which the income would have amounted if the income from such securities had accrued from day to day and been apportioned accordingly, then the income from such securities for such year shall be deemed to be the income of such person*” (Vakil No 1.com, 2012).

Section 94 of the IITA is essentially an anti-avoidance provision that provides a regulation pertaining to avoidance of tax by some transactions in securities for a person who holds beneficial interest in such securities (Singh & Kataria, 2012, P137).

## **2.9.2 INDIAN CASE LAW THAT ASCRIBES A MEANING TO BENEFICIAL OWNER**

A prominent Indian case selected for review was the *Aditya Birla Nuvo Limited v. DDIT*, (2011) 200 Taxman 437, which addressed beneficial owner in the backdrop of a treaty agreement in a tax evasion scheme.

*“In this case, a U.S. company and an Indian company entered into a joint venture (JV) and incorporated a company in India (Indian JV). The JV agreement allowed for the share ownership, voting, and management and control to be exercised by the JV partners, or through any of their ‘permitted transferees’, which had to be any entity that directly or indirectly was entirely owned by the JV partner. The U.S. company invested in the Indian JV through a Mauritian company. On the subsequent sale by the Mauritian company of its stake in the Indian JV, the question before the Bombay High Court was whether the Mauritian company was the beneficial owner of the capital gains resulting from the sale, so as to be entitled to the exemption available under the India-Mauritius tax treaty. The Bombay High Court held that the U.S. JV partner was the beneficial owner of the stake in the Indian JV as opposed to the ‘permitted transferee’ (that is, the Mauritian company) because of the clear stipulation in the JV agreement that the permitted transferee would not have any rights in the shares and would hold the same entirely for the benefit of the U.S. company.”* (Singh & Kataria, 2012:P137).

With regard to identifying the beneficial owner of the capital gain, this case was approached by looking at the economic reality of the facts rather than the legal ownership of the shares which was placed in the Mauritian company.

Essentially the USA company was identified as the beneficial owner on the basis that the company held rights to the shares of the Mauritian company and would therefore be entitled to the benefits of the shares in the Mauritian company. Had the Mauritian company not been acting as a conduit entity, it may have withstood scrutiny from the Revenue Authorities.

While it is not clearly indicated in the above extract, this case precludes a conduit company from qualifying as a beneficial owner. This is similar to the Commentaries to Article 10 of the OECD Model that precludes agents, conduit and similar entities from qualifying as a beneficial owner.

## **2.10 CHINA**

Beneficial owner is developing as a concept in China. In 2009 China's State Administration of Taxation ("SAT") promulgated Guoshuihan [2009] No. 601 ("Circular 601") which sets out an interpretation of beneficial ownership for treaties which is detailed under 2.10.1 (Ernst & Young, 2012:P1). According to Circular 601, an applicant has to satisfy strict requirements in order to qualify as a beneficial owner, which is a pre-requisite to enjoying the benefits of reduced withholding tax on dividends, interest and licensing fees under Chinese treaties (China Briefing, 2012).

Pursuant to the release of Circular 601, SAT issued Circular 30 which is aimed at further clarifying the concept of beneficial owner with respect to treaties (China Briefing, 2012). Apart from the issue of Circular 601 and Circular 30 which relates to treaties, the concept of beneficial owner does not appear in the Income Tax Legislation of China.

### **2.10.1 BENEFICIAL OWNER ACCORDING TO CHINA'S SAT: CIRCULAR 601 AND CIRCULAR 30**

Circular 601 defines the "beneficial owner" as the person who has the ownership and control right over the income or the rights of property that generates income and that beneficial

owner generally engages in substantive operational activities.<sup>2</sup> The Circular precludes entities such as agents and conduit companies from qualifying as a beneficial owner.

Paragraph 2 of the Circular sets out seven factors which could negatively affect a recipient's status as a beneficial owner:

1. the recipient is obliged to distribute or pay all or majority of its income (more than 60%) to a resident in a third country within a fixed time period (such as 12 months of receipt);
2. the recipient does not have any business activities except the holding of rights or assets generating income;
3. for a corporate entity, its assets, size and staff arrangement are not commensurate with its income;
4. the recipient has no or minimal control over its income, assets or rights and does not take any business risk;
5. the relevant income of the recipient is non-taxable or subject to a low tax rate in the contracting country;
6. in the case of payment of interest under a loan agreement, the existence of another loan or deposit agreement between the lender and a third party; and the amount, interest rate and the time of conclusion of the third party contract are similar to those of the first loan agreement; and
7. in the case of royalty income, the existence of another agreement on copyright, patent and technology licensing or transfer between the applicant and a third party, in addition to the royalty payment agreements

Circular 30 prescribes that when authorities are determining whether beneficial ownership exists, the analysis can be based on a number of documents, such as: Articles of Association, Financial Statements, Board Minutes and Resolutions, Functional Analyses, Loan Contracts, Transfer Contracts, Asset Ownership Certificates and Invoice Registers (China Briefing, 2012).

Circular 601 does not prescribe a pure technical or legal approach when establishing who qualifies as a beneficial owner (Wang & Co, 2012). The interpretation provided by Circular 601 is meant to take into account the purpose of the relevant Chinese treaties as well as the

---

<sup>2</sup> A performance of manufacture, distribution or management functions, but not a possession of a substance which is barely enough to meet the minimum legal requirements.

economic realities of the relevant treaty by analysing the facts of the particular treaty (Wang & Co, 2012). In contrast to Circular 601, Circular 30 has a more legalistic approach because it guides the authorities to review legal documentation when determining if a recipient qualifies as a beneficial owner.

Circular 601 identifies with the Commentaries to Article 10 of the OECD and UN Models with regard to the preclusion of agents and conduit entities from qualifying as a beneficial owner (Refer 3.2). It further contains the phrases such as “right over the income” and “rights of property” which was evidenced in the study of the concept in domestic law (Refer Chapter 2). Overall, it appears that Chinese legislation is considering both the substance of the matter and legal form pertaining to beneficial owner in relation to income or property, albeit in a treaty context only.

## **2.11 CONCLUSION**

At a first glance, it appears as if all countries, in both developed and developing countries that apply common law and civil law systems, are trying to ascribe their own meaning to beneficial ownership. Generally, beneficial owner is more recognised in the developed countries where the concept originated. In contrast, the concept is relatively new in the developing countries of Brazil, Russia and China. In addition, there are common elements prevalent between domestic law of the selected countries and the judicial decisions discussed in a treaty context in Chapter 4, as well as the Commentaries to Article 10 of the OECD (including proposed amendments) regarding the meaning of beneficial owner.

### **2.11.1 IMPACT OF DIVERSE LANGUAGES ON THE INTERPRETATION OF BENEFICIAL OWNER**

Beneficial owner is used across the various selected countries in this study that use different languages. Ideally the concept should be commonly understood across the various languages. Beneficial ownership originated in the UK, hence its meaning is largely derived from the English language. One of the main reasons for the divergent interpretations of the concept in domestic law is that most countries translate the concept into their own respective languages, for example Brazil, Russia and China. Once the concept is translated into a non English-speaking language, it does not necessarily retain its originally intended meaning. It follows that beneficial ownership is often not translated literally into the language of the non English-

speaking country (Du Toit, 1999:P98). It is instinctive for residents of a non English-speaking country to give preference to the meaning of the concept in their own language and such meaning may not be the same when translated in English (Du Toit, 1999:P98). This may result in conflicting interpretations to a concept that is intended to have a common meaning.

### **2.11.2 BENEFICIAL OWNER IN DOMESTIC LAW OF DEVELOPED COUNTRIES**

The USA and UK in particular, according to the case law selection, give due regard to rights and attributes of ownership as oppose to the mere legal title of ownership, typically associated with the substance over form doctrine. Canadian law reiterates the substance over form doctrine and also provides attributes of ownership such as possession, risk, use and control to identify a beneficial owner.

These attributes are highlighted in the treaty cases of Velcro and Prevost in Chapter 4. The USA, UK and Canada recognise that a recipient is able to qualify as a beneficial owner of property or income even though such recipient does not own the legal title. Thus, there appears to be a strong alignment to the interpretation of beneficial ownership in the selected developed countries.

### **2.11.3 BENEFICIAL OWNER IN DOMESTIC LAW OF DEVELOPING COUNTRIES**

Beneficial ownership is in its early stages of establishment in Brazil, Russia and China, with the exception of India where the concept is more recognised. These countries, with the exception of India practice civil law where legislation is largely based on codifications of enacted law. Brazil, Russia and China do not have much case law on the concept and have adopted a prescriptive approach in their domestic laws and circulars by identifying a list of set criteria or factors that outline methods of understanding of beneficial ownership (Committee of Experts on International Cooperation in Tax Matters, 2010:P4). China is a key example where the Circular identifies a beneficial owner according to the attributes of a recipient that receives income.

Brazil, China and Indian law precludes conduit or similar entities from qualifying as beneficial owners which is in line with the view of the Commentaries to Article 10 of the OECD and UN Models (refer Chapter 3). Russia, India and China prescribe looking into the

economic realities and the right of ownership to establish the authenticity of the concept which aligns with the substance over form doctrine in developed countries.

Despite minor differences, developing countries appear to share similar aspects in relation to the interpretation of beneficial owner.

#### **2.11.4 THE IMPACT OF THE DOMESTIC LAW ON THE INTERPRETATION OF BENEFICIAL OWNER IN A TREATY CONTEXT**

It appears that the OECD is proposing to apply certain elements of the domestic interpretation of beneficial owner in the Commentaries to Article 10 of the OECD Model. This is evidenced by the expressions “the right of the owner to enjoy the fruits of it or dispose of it for his own benefit” and “the right to its enjoyment” which is similar to “right to use and enjoy income” used by the OECD in the 2012 proposed amendments (refer 3.2.9). In addition, these expressions also find their way in the decisions of Prevoist and Velcro (Chapter 4) which are treaty cases.

Also, the domestic law of Brazil, India and China includes a preclusion of conduit entities from qualifying as a beneficial owner which forms an essential part of the interpretation of beneficial owner in Commentaries to Article 10 of the OECD and UN Models.

Domestic law has different policy aims to that of treaties and it is therefore understandable that the interpretation of beneficial owner may differ in some instances (Refer 5.5.3). However, based on the findings in this chapter, the interpretations in domestic law and the Commentaries to Article 10 of the OECD Model as well as certain case law appear to support each other in some instances. In view of the flexible interpretation to the concept, the OECD has therefore motivated an autonomous/international fiscal meaning in the proposed amendments which is intended to be commonly understood from an international treaty perspective (Refer 3.2.9).

#### **2.11.5 COMMON FACTORS OF BENEFICIAL OWNER DEFINITIONS OR USES IN DOMESTIC LAW**

The domestic legislation and practices of countries across the world regarding the application of beneficial ownership are varied and therefore different interpretations are bound to occur (Committee of Experts on International Cooperation in Tax Matters, 2010:P4). There is evidently not one composite meaning of beneficial owner in domestic law. However some



commonalities have been identified which is evidenced in the following expressions extracted out of domestic law of the selected countries: “right at least to some extent to deal with the property as your own”, “beneficial enjoyment”, “right to its enjoyment”, “right to such beneficial use or interest”, “control and demand over property”, “entitled to the use and benefit of the property”, “possession”, “use”, “risk”, “actual beneficiary”, “real beneficiary” and “ultimate beneficiary”. Also, certain countries share common principles/concepts like the substance over form doctrine as well as the preclusion of nominees, agents and conduit entities from qualifying as a beneficial owner.

The common aspects identified indicates that the domestic law of common law and civil law jurisdictions are moving closer to a consistent understanding of beneficial owner from a domestic law perspective. In addition, domestic law appears to support the concept in a treaty context which is evidenced by the common elements identified in the OECD Model and international treaty cases. On this basis, domestic law of other countries would be a valuable source for SA to draw on in support of its meaning in SA’s DT legislation.

## CHAPTER 3: BENEFICIAL OWNER IN THE OECD AND UN MODELS

### 3.1 INTRODUCTION

The scope of this chapter will cover and contrast beneficial owner as it developed in the OECD and UN Models. The OECD Model and UN Model are the two major international conventions used by most countries as a starting point for tax treaty negotiations (Kosters, 2004: P4). The UN Model derives its basis from the OECD Model. The essential distinction between the OECD and UN Models is that the OECD Model is a framework for treaties concluded between developed countries. In contrast the UN Model provides a framework for treaties concluded between developing and developed countries. Like the OECD Model, the UN Model is published in various languages and therefore also experiences interpretational issues due to language barriers that are not conducive to a common understanding of treaties.

Beneficial owner is contained in Articles 10 (Dividends), 11 (Interest) and 12 (Royalties) and the related Commentaries in both Models in relation to passive income. This dissertation will only address beneficial owner as it appears in the Commentaries to the Dividend Article 10 of both Conventions.

Beneficial owner is not defined<sup>3</sup> in both the OECD and UN Models and still appears to be a developing concept in both Conventions. The OECD Model was the first Convention to introduce beneficial owner into fiscal usage and therefore this chapter commences with the concept as it developed in the OECD Model (Committee of Experts on International Cooperation in Tax Matters, 2008:P9).

The Commentaries to Article 10 of the UN Model is a derivation of the provisions of the OECD Model with regard to beneficial owner (UN Model, 2011:Pvi). The developments of the concept commences with a study of beneficial owner as it appears in the Commentaries to Article 10 of the OECD and UN Models since its inception, followed by periodic amendments to the OECD and UN Models as well as current developments by the Working Party of the OECD.

---

<sup>3</sup> Article 3(2) of both models support a domestic meaning given to a term that is not defined in a treaty unless context indicates otherwise (OECD Model, 2010:P23).

## **3.2 BENEFICIAL OWNERSHIP IN THE OECD AND UN MODELS**

### **3.2.1 THE INTERNATIONAL ARRIVAL OF BENEFICIAL OWNERSHIP IN THE OECD AND UN MODELS**

Beneficial ownership was introduced as a concept in the 1977 version of the OECD Model (Article 10 and Commentaries) when the international convention was formally published for the first time (Collier, 2011:P686).

The UN Model was first introduced in 1980 and derives its basis from the 1977 version of the OECD Model. The UN Model was then amended in 2001 and is replicated from the amendments (other than beneficial owner) in the 1995 version of the OECD Model (Committee of Experts on International Cooperation in Tax Matters , 2008:P5).

Article 10 and its Commentaries in the 2011 UN Model is reproduced from the provisions of the 2010 OECD Model (UN Model, 2010:P176). Given that the provisions of the UN Model are derived from the OECD Model, this chapter will only include extracts from the OECD Model henceforth.

### **3.2.2 BENEFICIAL OWNER IN THE 1977 COMMENTARY TO ARTICLE 10 OF THE OECD MODEL**

The original, 1977 Commentary to Article 10 of the OECD Model contained only the following short explanation of beneficial ownership:

*“Under paragraph 2, the limitation of tax in the State of source is not available when an intermediary, such as an agent or nominee, is interposed between the beneficiary and the payer, unless the beneficial owner is a resident of the other Contracting State. States which wish to make this more explicit are free to do so during bi-lateral negotiations.”*

The 1977 Commentary to Article 10 only refers to beneficial owner being a resident of the Other Contracting State. There is no interpretation of or an attempt to provide a meaning to the concept.

### **3.2.3 BENEFICIAL OWNERSHIP IN THE CONDUIT COMPANIES REPORT OF 1986 (“Conduit Report”)**

Almost ten years following its introduction in the OECD Model, beneficial owner was brought to the fore by the OECD in the Conduit Report (Economic and Social Council Committee of Experts on International Cooperation, 2008:P7). The report included an Anti-Avoidance measure<sup>4</sup> which confirmed that nominees, agents as well as formal owners of certain assets, holding very narrow powers, are excluded from the meaning of beneficial ownership because such owners do not hold the biggest weight of ownership attributes in relation to such assets and consequently their status amounts to mere fiduciaries or administrators which are precluded from qualifying as being beneficial owners (Du Toit, 1999: P134).

### **3.2.4 BENEFICIAL OWNER IN THE 2003 COMMENTARY TO ARTICLE 10 OF THE OECD MODEL**

Subsequent to the Conduit Report, the Commentary to Article 10 of the OECD Model was expanded in 2003 to accommodate the discussion in 1986. Paragraph 12 of the 2003 Commentary suggests that beneficial owner is an anti-avoidance mechanism because it specifically outlines that the concept should not be used in a narrow technical sense and should rather be understood in its context and in light of the object and purpose of the DTA which includes the avoidance of double taxation and the prevention of fiscal evasion and avoidance.

Subparagraph 12.1 of the 2003 Commentary incorporated certain elements of the Conduit Report which excludes conduit entities from qualifying as a beneficial owner. The amendments to beneficial owner emerging from the Conduit Report of 1986 were only adopted in 2003 by the OECD Model and was therefore not included in the 2001 version of

---

<sup>4</sup> “Articles 10 to 12 of the OECD Model deny the limitation of tax in the State of source on dividends, interest and royalties if the conduit company is not its “beneficial owner”. Thus the limitation is not available when, economically, it would benefit a person not entitled to it who interposed the conduit company as an intermediary between himself and the payer of the income ... The Commentaries mention the case of a nominee or agent. The provisions would, however, apply also to other cases where a person enters into contracts or takes over obligations under which he has a similar function to those of a nominee or an agent. Thus a conduit company can normally not be regarded as the beneficial owner if, though the formal owner of certain assets, it has very narrow powers which render it a mere fiduciary or an administrator acting on account of the interested parties (most likely the shareholders of the conduit company) (Du Toit, 1999:P133)”.

the UN Model (Committee of Experts on International Cooperation in Tax Matters, 2008:P15).

### **3.2.5 BENEFICIAL OWNER IN THE COMMENTARY TO ARTICLE 10 OF THE 2010 OECD MODEL**

Beneficial owner further developed in the 2010 OECD Model which is the current version in effect. As it currently stands, the 2011 UN Model is a reproduction of the provisions of the OECD Model with respect to Article 10 and its Commentaries, with the exception of substantive differences relating to withholding tax rates. (UN Model, 2010:P176).

The critical elements of beneficial owner in the Commentary of Article 10 are outlined:

- The Commentary indicates that the requirement for beneficial ownership was introduced into paragraph 2 of Article 10 to clarify the meaning of the words *“paid by a company which is a resident of a Contracting State to a resident of the other Contracting State”* which appears in paragraph 1 of Article 10 (OECD Commentary, 2010, P187). Essentially, the Source State from which the dividend income is derived is not required to give up taxing rights over the dividend income merely because the immediate recipient is a tax resident of the Contracting State with which the Source State had concluded a treaty (OECD, 2010, P187).
- It follows that the concept should not be interpreted in a narrow technical sense and should be understood in its context and in light of the object and purpose of the treaty. This includes avoiding double taxation and the prevention of fiscal evasion and avoidance (OECD, 2010, P187).
- It further includes the preclusion of a conduit or similar entity from qualifying as a beneficial owner. The Commentary indicates that to grant treaty relief to a tax resident of a Contracting Country that is the recipient of a dividend would not be consistent with the object and purpose of the treaty if such recipient acts in the capacity of an agent or nominee; or as a conduit for another person, who in fact receives the benefit of the dividend concerned (OECD, 2010, P187).

### **3.2.6 PITFALLS OF BENEFICIAL OWNER IN THE COMMENTARY TO ARTICLE 10**

#### **3.2.6.1 Beneficial owner lacks a definition**

Like the previous versions of the OECD Model, the 2010 version does not include a definition of beneficial owner and is therefore open to various interpretations.

#### **3.2.6.2 Divergent domestic laws restricts a common understanding to beneficial owner**

The use of the provided guideline of the OECD Commentary to Article 10 in conjunction with Article 3(2) is useful to the extent that it provides for the concept to be interpreted in accordance with domestic law unless the context of the treaty indicates otherwise. However, the application of domestic law to the interpretation of beneficial owner is a potential limitation because of divergent domestic laws applicable to various contracting parties to a common treaty. In addition, various countries also apply their own distinctive languages to their understanding of beneficial owner which results in divergent interpretations to a concept that is meant to have a common understanding in a treaty.

#### **3.2.6.3 “In the context and in light of the object and purpose of the treaty” is interpretive and therefore not a conclusive mechanism in defining beneficial owner**

Determining the meaning of beneficial owner in the context and in light of the object and purpose of the treaty is also a limitation in the sense that each contracting party may have a different understanding of the object and purpose of the treaty. This understanding may be exacerbated by the practice of different legal systems as well as the usage of different languages that lack a common understanding between contracting parties to a treaty.

#### **3.2.6.4 Disqualifying an agent, nominee or conduit from qualifying as a beneficial owner is very narrow from a treaty shopping perspective**

Treaty shopping<sup>5</sup> is a form of treaty abuse that can reduce withholding taxes, recharacterise income to exempt which is otherwise taxable income and can result in double non-taxation of

---

<sup>5</sup> The practice of structuring a multinational business to take advantage of more favorable tax treaties available in certain jurisdictions. A business that resides in a home country that doesn't have a tax treaty with the source country from which it receives income can establish an operation in a second source country that does have a

income (Krishna & Gervais, 2009:P130). The preclusion of an agent, nominee or conduit from qualifying as a beneficial owner is very narrow because it does not deal with all entities that may not qualify as a beneficial owner and consequently all instances of treaty shopping.

### **3.2.6.5 Conclusion of the limitations to the 2010 OECD Model**

Beneficial owner is vulnerable to a flexible interpretation in view of the above limitations. Accordingly there is a need to establish an autonomous meaning that is commonly interpreted internationally. Baker, in his analysis of the Indofood case (Refer 4.2) concluded that beneficial owner should be given an international fiscal meaning. This view is substantiated by the fact that beneficial owner was introduced into international fiscal usage through works of the OECD and treaties entered into by various countries which adopt the concept in their domestic legislation (Committee of Experts on International Cooperation in Tax Matters, 2008:P9).

### **3.2.7 PROPOSED AMENDMENTS TO BENEFICIAL OWNER BY THE OECD IN 2011**

In view of the developing and controversial nature of beneficial owner, the OECD released proposals in a Public Draft Discussion (“PDD”) in April 2011 aimed at clarifying the meaning of the concept in the OECD Model. In response to public comments received as at 15 July 2011, the OECD released a further revision to the PDD concerning the meaning of beneficial owner on the 19 October 2012 (Refer 3.2.9).

Summarised points in the PDD in relation to beneficial owner:

#### **3.2.7.1 Relevance of domestic law versus an autonomous meaning to beneficial owner**

The term beneficial owner was included in Article 10(1) to address the potential difficulties arising from the words “paid to a ... resident” of the other Contracting State in relation to dividends. The concept is intended to be interpreted in this context and should not be constrained by the legal technical meaning the term may have under the domestic law of a specific country (OECD, 2011:P3). By implication, this paragraph indicates that beneficial owner should be given an international meaning.

---

favorable tax treaty in order to minimize its tax liability with the home country. Most countries have established anti-treaty shopping laws to circumvent the practice (Business Dictionary.com, 2012).

The PDD included a further sentence in subparagraph 12.1 which states that domestic law is not irrelevant and may provide assistance in interpreting beneficial ownership to the extent that the legal principles are consistent with the general guidance provided by the OECD Commentary (OECD, 2011: P3).

#### **3.2.7.2 Beneficial owner is the recipient that has full right to use and enjoy the income unconstrained by a contractual or legal obligation to pass payment**

The recipient of a dividend is the beneficial owner when that recipient has the full right to use and enjoy the income unconstrained by a contractual or legal obligation to pass payment received to another person. The PDD continues that an obligation to pass payment to another person is normally determined from relevant legal documents or it would be based on the factual circumstances of the respective treaty (OECD, 2011).

#### **3.2.7.3 Beneficial owner used as a combat to the abuse of treaty provisions, treaty shopping or tax avoidance**

The fact that the recipient of a dividend is considered to be a beneficial owner of a dividend does not mean that the limitation of tax is automatically granted. In the cases of abuse of treaty provisions, the limitation on tax should not be granted, even if the recipient of the dividend is regarded as the beneficial owner of that dividend (OECD, 2011:P3).

Beneficial owner is a tool for dealing with some forms of tax avoidance or treaty shopping. The concept should however not be considered as a restrictive application to other approaches addressing treaty shopping or tax avoidance cases (OECD, 2011).

### **3.2.8 REACTION FROM THE PUBLIC TO THE PDD**

In response to the release of the public draft discussion in April 2011, various comments have been received from interested parties around the world and they have been published on the OECD website. It appears that many interest parties welcome the fact that the OECD has made a concerted effort to provide more guidance to the concept of beneficial ownership.

However, there are critical issues implicit in the PDD which gives rise to further uncertainty with regard to the meaning of beneficial owner.



Fundamental issues and comments from interested parties in response to the PDD:

### **3.2.8.1 Proposed amendments results in reinterpretation of beneficial owner**

There is a concern that the proposed amendments may lead to a reinterpretation of beneficial owner rather than provide the intended clarity to the concept (Capital Markets Tax Committee of Asia, 2011). This is a critical issue because it directly impacts the interpretation of existing DTAs as opposed to those entered into subsequent to the change of interpretation.

### **3.2.8.2 Domestic law contradicts the conclusion of an autonomous meaning**

A majority of comments supported the conclusion that an autonomous meaning should be given to the term “beneficial owner”, although the reference to domestic law in the last sentence of subparagraph 12.1 appears to contradict the conclusion of an autonomous meaning (OECD, 2012: P4).

### **3.2.8.3 Beneficial owner does not deal with all instances of treaty shopping**

Some responses do not welcome the anti-avoidance commentary relating to beneficial owner because it is too narrow and only addresses certain cases of anti-avoidance and not all cases of treaty shopping (Loan Markets Association, 2011). For example, the OECD Model precludes nominees, agents and conduits acting in a fiduciary capacity from qualifying as a beneficial owner. The reservation of this provision would be whether the OECD has identified all types of entities that would not qualify as a beneficial owner. Consequently, beneficial owner may not be a foolproof anti-avoidance tool for tax purposes. Hence, there may be a need for a separate anti-avoidance provision which addresses entities that do not qualify as a beneficial owner.

### **3.2.8.4 “Full right to use and enjoy” has been outlined as ambiguous**

The expression “*full right to use and enjoy unconstrained by a contractual or legal obligation to pass the payment received to another person*” as it is included in the proposed amendments has been outlined as too ambiguous and difficult to interpret in practice which should either be further clarified or excluded from the amendments (Jones, Vann, Wheeler, 2011:P6). “Full right” implies all instances of ownership and therefore the expression has a strictly legal implication to it which in essence precludes a substance over form test.

### **3.2.9 OCTOBER 2012 REVISED PROPOSALS CONCERNING THE MEANING OF BENEFICIAL OWNER**

In light of the public comments received on the PDD, the OECD released Revised Proposals concerning the meaning of beneficial owner in October 2012.

The key aspects of beneficial owner in the Revised Proposals are:

#### **3.2.9.1 Issue of autonomous treaty meaning versus domestic law meaning**

The last sentence in subparagraph 12.1 appears to contradict the conclusion that an autonomous meaning should be preferred over domestic law. Consequently it was deleted from the PDD in the revised proposals (OECD, 2012:P4). Indofood was the first case where reference was made to ascribing an international fiscal meaning to beneficial owner in a treaty context which appears to align with the proposed amendments by the OECD (Chapter 4).

#### **3.2.9.2 Deletion of the phrase “full right to use and enjoy the dividend”**

A majority of the comments received objected to the ambiguity of the phrase “full right to use and enjoy” the income in subparagraph 12.4 and therefore it was deleted and replaced with the “right to use and enjoy” the income in the revised proposals (OECD, 2012:P5). The Working Party recognized that the drafting of paragraph 12.4 could give rise to significant uncertainty and that the paragraph needed to better identify the kind of obligations associated with the beneficial owner of the dividend (OECD, 2012:P10). This phrase was discussed by the Indonesian Authorities in the Indofood case (Refer 4.2.2).

#### **3.2.9.3 “...constrained by a contractual or legal obligation to pass on the payment received to another person”**

The expression “constrained by a contractual or legal obligation to pass on the payment received to another person” has been retained in the revised proposals. The OECD has however modified the type of obligations to state that an obligation to pass on the payment must be “related” to the payment received. Hence if an obligation to make a payment is “unrelated” to the payment received, it will not be relevant to the test of beneficial ownership. This is similar to the principles discussed in the Indofood and A/AS case (Refer Chapter 4).

#### **3.2.9.4 Beneficial owner as a treaty shopping mechanism**

The PDD comment regarding treaty shopping and the need to satisfy any relevant preventative treaty shopping measures have been retained in the revised proposals.

#### **3.2.10 CONCLUDING REMARKS ON THE PDD AND REVISED PROPOSALS CONCERNING BENEFICIAL OWNER**

Overall, the PDD was a welcome approach in establishing a common meaning for beneficial owner. However, there were some grave issues implicit in the PDD which warranted the Revised Proposals released in October 2012. The Revised Proposals appear to address some of the issues identified in the April 2011 PDD. Whether it resolves all issues associated with interpreting beneficial owner is debatable and was still open to comment from the public up until 15 December 2012. In conclusion, it appears that the OECD is moving towards establishing an autonomous/international fiscal meaning to beneficial owner which was indicated by the amendment to subparagraph 12.1 in the revised proposals to the Commentary of Article 10. This would seem to be a favourable conclusion given that there is a need for the notion to be consistently understood by all interested parties.

### **3.3 CONCLUSION**

Beneficial owner remains an undefined term in both the OECD Model and UN Model and is utilised in numerous treaties that are in effect across various countries in the world. An obvious contrasting point is that beneficial owner was adopted in the UN Model a few years after its inception in the OECD Model. Subsequently, there is also a time lag between the adoptions of the effective amendments made to the OECD model. Beneficial owner is clearly still a developing concept as evidenced through the works of the OECD since its inception in the OECD Model in 1977 to the revised proposals of interpretation that are currently pending finalisation. There appears to be a great level of correlation in the interpretation of beneficial owner between the OECD Model and the UN Model due to the fact the UN Model is reproduced from the OECD Model. Due to its controversial nature, neither model has managed to tailor a consistent meaning to the concept. Nevertheless, there has been a firm attempt by the OECD, to establish a definitive meaning to the concept.

Therefore, in conclusion there is no crucial difference between the two Conventions as far as beneficial owner is concerned. However the concept is still flexibly interpreted. Understandably, the OECD has therefore made a concerted effort to drive an autonomous meaning to the concept which is evidenced through the release of the PDD in April 2011 and revised proposals in October 2012 which is pending finalisation. Based on prior practice, it is expected that the amendments will be adopted by the UN Model once it has been added to the OECD Model. It should be noted that many of the principles and expressions in the OECD and UN models as well as the proposed amendments appear in the domestic law of countries (Chapter 2) as well as the international cases in Chapter 4 which are valuable to the interpretation of beneficial owner both from a domestic as well as treaty context.

University of Cape Town

## CHAPTER 4: BENEFICIAL OWNER IN INTERNATIONAL COURTS

### 4.1 INTRODUCTION

Following the study of beneficial owner as it appears in the foundation of international conventions, a natural question arises as to how beneficial owner is interpreted by international courts. This chapter will address the core outcomes of four international cases that have contributed to the evolutionary meaning of beneficial owner. Each case analysed the concept against the backdrop of a treaty that confers favourable withholding tax rates to the recipient that qualifies as the beneficial owner. It should be noted that each case is a dispute in a treaty context and does not address the concept from a domestic law perspective. The concept was addressed in some instances of international case law from a domestic law perspective in Chapter 2. Prevost however did consider domestic law as part of the proceedings of the case.

The four cases in question are:

- Indofood (UK)
- Prevost (Canada)
- Velcro (Canada)
- A/AS (Switzerland)

### 4.2 SIGNIFICANT OUTCOMES OF INDOFOOD

#### 4.2.1 SUMMARY OF FACTS

Indofood was essentially a question of whether a Netherlands entity (SPV 2”) interposed between an Indonesian borrower and loan investors qualified as a beneficial owner. Indofood (parent entity) initially established a Mauritian entity (“SPV 1”) for the purposes of issuing bonds to loan investors which was subsequently replaced with SPV2.

Like the Indonesian Authorities concluded that SPV1 was a conduit entity, the UK Court held that SPV 2 was a conduit that was formed with the express purposes of taking advantage of the favourable withholding tax rates in the Netherlands and therefore did not qualify as the beneficial owner of the interest income.

#### **4.2.2 DOES “FULL RIGHT TO ENJOY THE DIRECT BENEFITS OF INCOME” CONFER BENEFICIAL OWNER STATUS**

According to the Indonesian Tax Authorities, beneficial owner means the actual owner of the income who “*truly has the full right to enjoy*” the direct benefits of such income (Indofood, 2006:P26). This expression is questionable to the extent that it implies that a recipient can only qualify as a beneficial owner if such recipient holds all the rights of ownership associated with the income (Yip, 2006:P50). Furthermore, this expression denotes a strict legal implication and would therefore preclude the substance over form doctrine when testing for a meaning of the concept.

Interestingly, this expression has found its way into the PDD released by the OECD in April 2011 after the decision of Indofood. Due to its ambiguity, this expression was removed in the revised proposals of October 2012 (Chapter 3).

#### **4.2.3 PRECLUSION OF A CONDUIT ENTITY QUALIFYING AS A BENEFICIAL OWNER**

SPV 1 was interposed in a DTA between Indofood and the investors to facilitate the payment of interest income to the loan investors at a reduced withholding tax rate to the parent entity. Indofood transferred a payment of interest income to SPV 1 one day before it was due for payment to the investors (Baker, 2007:P19). As a result, SPV 1 did not have the right to enjoy the income because it was obliged to pay the interest to the investors almost immediately after receiving the payment from Indofood.

SPV 1 appeared to be a conduit entity that was formed for the purposes of facilitating a payment to the loan investors. Accordingly the Indonesian Tax Authorities terminated the terms of the Indonesia-Mauritius treaty on the premise that special purpose vehicles in the form of a “conduit company”, “paper box company”, “pass-through company” and other similar entities do not qualify as beneficial owners (Yip, 2006:P50).

Subsequent to the termination of SPV 1, a new entity was formed in the Netherlands that served as a similar conduit structure as SPV 1. SPV 2 was interposed between the Indofood and the investors with the express purposes of utilising the reduced withholding tax rate in the Netherlands. Like SPV 1, the judiciary concluded that SPV 2 was a conduit structure and

therefore did not qualify as the beneficial owner of the interest income paid by Indofood.<sup>6</sup> Furthermore, Baker in his commentary of Indofood reiterated the preclusion of a conduit entity from qualifying as a beneficial owner in Paragraph 37 of the case:

*“The essence of this Commentary is to explain that the "beneficial ownership" limitation is intended to exclude:*

- a) mere nominees or agents, who are not treated as owners of the income in their country of residence;*
- b) any other conduit who though the formal owner of the income, has very narrow powers over the income which render the conduit a mere fiduciary or administrator of the income on behalf of the beneficial owner.”*

#### **4.2.4 DOES SPV 2 QUALIFY AS THE BENEFICIAL OWNER IF THERE IS A LEGAL OBLIGATION TO PAY THE INTEREST TO INVESTORS?**

An interesting question arose as to whether SPV 2 would qualify or be disqualified as the beneficial owner of the interest income on the premise that SPV 2 had a legal obligation to pay an amount of interest income to the loan investors (Du Toit, 2010:P506).

The judiciary of Indofood held the following in this instance:

*“the Issuer is bound to pay to the Principal Paying Agent that which it received from the Parent Guarantor because it is precluded from finding the money from any other source by the Note Conditions”* (Indofood, 2006: Paragraph 43).

Like SPV 1, SPV2 was contractually obliged to pay over the moneys that it received from Indofood to the investors. SPV 2 did not enjoy the benefit of the moneys received from Indofood because the interest was paid to the investors one day after SPV 2 received it.

SPV 2 was also barred from finding the money from another source to pay the interest to the loan investors. Consequently, SPV 2 had no rights over the money and therefore did not qualify as the beneficial owner.

---

<sup>6</sup> *“Articles 10 to 12 of the OECD Model deny the limitation of tax in the State of source on dividends, interest and royalties if the conduit company is not its "beneficial owner". Thus the limitation is not available when, economically, it would benefit a person not entitled to it who interposed the conduit company as an intermediary between himself and the payer of the income (Indofood,2006: P35).”*

#### **4.2.5 SUBSTANCE OVER FORM DOCTRINE**

The question was whether SPV 2 qualified as the beneficial owner of the interest income that was paid by Indofood in view of its station in a treaty favourable jurisdiction.

To this extent Paragraph 44 of Indofood supports the substance over form doctrine which reads:

*“But the meaning to be given to the phrase ‘beneficial owner’ is plainly not to be limited by so technical and legal an approach. Regard is to be had to the substance of the matter. In both commercial and practical terms the Issuer is, and Newco would be, bound to pay on to the Principal Paying Agent that which it receives from the Parent Guarantor.”*

and

*“In practical terms it is impossible to conceive of any circumstances in which either the Issuer or Newco could derive any ‘direct benefit’ from the interest payable by the Parent Guarantor except by funding its liability to the Principal Paying Agent or Issuer respectively. Such an exception can hardly be described as the ‘full privilege’ needed to qualify as the beneficial owner, rather the position of the Issuer and Newco equates to that of an ‘administrator of the income’”.*

SPV2 was only the legal owner of the interest and did not enjoy the benefit or have a right over the moneys received from Indofood. This was substantiated by the fact that SPV 2 was contractually bound to pay the same amount of interest that it received from Indofood to the loan investors one day after it had received payment (Baker, 2007:P19). The court held that SPV 2 was a conduit entity that merely facilitated the interest payment to investors and therefore did not qualify as the beneficial owner.

#### **4.2.6 BENEFICIAL OWNER SHOULD BE ACCORDED WITH AN INTERNATIONAL FISCAL MEANING**

Indofood was the first case where the Court made reference to ascribing an international fiscal meaning to the concept of beneficial owner (Baker, 2007:P23). The facts of Indofood were first considered by the Indonesian Revenue Authorities, and then by a court in the Netherlands with the final decision pronounced in a court of the UK. Presumably the courts and authorities of each country had different interpretations to the same concept given that the native language, legislative acts and legal systems of each country were different.



Baker concluded that beneficial owner should be given an international fiscal meaning which should not be limited to a meaning given by the domestic law<sup>7</sup> of a specific country which in Indofood was the UK (Baker, 2007:P23). Accordingly for treaty purposes, it seems appropriate that beneficial owner should be ascribed with an international fiscal meaning which is consistently understood by all countries, and not vary from one country to another (Baker, 2007:P23).

## **4.3 SIGNIFICANT OUTCOMES OF PREVOST**

### **4.3.1 SUMMARY OF FACTS**

Prevost involved the question of whether a Netherlands entity (“PHBV”) or the shareholders of PHBV qualified as the beneficial owner of dividend income received from Prevost, the parent entity. The shares in PHBV were held by Volvo Bus Corporation (“Volvo”) and Henlys Group PLC (“Henlys”). According to the shareholders’ agreement, 80% of the profits that PHBV received from Prevost were to be distributed to the shareholders, subject to the Corporate Group having sufficient financial resources to effect payment. In its final hearing, the Court concluded that PHBV was the beneficial owner of the dividend income.

### **4.3.2 ORDINARY MEANING OF BENEFICIAL OWNER IN VIEW OF RULES OF INTERPRETATION**

Prevost considered meaning of beneficial owner under the domestic laws of Canada in accordance with Article 3(2)<sup>8</sup> of the OECD Model as well as the guidelines in the Vienna Convention on the Law of Treaties (“VCLT”). Beneficial owner is not defined in the Canadian Income Tax Act, nor did the treaty between Canada and the Netherlands contain a definition. The court referred to the following interpretive methods of the VCLT:

- A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose (Prevost:P37).

---

<sup>7</sup> Article 3(2) of the OECD and UN Models supports a domestic meaning given to a term like beneficial owner that is not defined in a treaty unless the context indicates otherwise (OECD Model, 2010:P23).

<sup>8</sup> “As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.”

- Tax treaties are to be given a liberal interpretation with a view of complementing the true intentions of the contracting states. The paramount goal is to find the meaning of the words in question (Prevost: P37).

Canada is a jurisdiction where both common law and civil law systems as well as French and English languages are part of the country's establishment (Department of Justice Canada: June 2012). The Court was able to conclude on various permutations of the meaning of beneficial owner in the backdrop of different languages and legal systems. The case of Prevost could therefore be interpreted in English and French as well as Dutch by virtue of the contracting party to the treaty being a resident of the Netherlands (PHBV). The Court lent some advice from a law expert in the Netherlands who translated the Dutch version of the concept "*uiteindelijk gerechtigde*" into "he who is ultimately entitled" (Prevost, 2008: Paragraph 68). The French version of beneficial owner, "*bénéficiaire effectif*" which translates into real beneficiary does not appear in the French version of the Canadian Income Tax Act (Prevost, 2008: Paragraph 68).

#### **4.3.3 MEANING ASCRIBED TO BENEFICIAL OWNER FROM JUDICIAL PRECEDENTS**

Prevost referred to judicial precedents which considered the meaning of beneficial owner:

- *"In Jodrey Estate the Supreme Court found that the plain ordinary meaning of the expression "beneficial owner" is the real or true owner of the property. The property may be registered in another name or held in trust for the real owner, but the "beneficial owner" is the one who can ultimately exercise the rights of ownership in the property"*(Prevost, 2008: Paragraph 74).
- The following rules of interpretation emerged from the Hoge Raad case which the judiciary of Prevost considered: *"A person is the beneficial owner of a dividend if i) he is the owner of the dividend coupon, ii) he can freely avail of the coupon, and iii) he can freely avail of the monies distributed"* (Prevost, 2008: Paragraph 43).

The above cases attempted to identify certain attributes of ownership associated with beneficial owner. However, a conclusive definition has not been tailored in either case.

#### 4.3.4 PRECLUSION OF A CONDUIT ENTITY FROM QUALIFYING AS A BENEFICIAL OWNER

The court considered the provisions of the OECD Model which precludes a conduit, nominee or agent from qualifying as beneficial owner. Their view was that such an entity has only title to property or income, but no economic or practical attributes of ownership<sup>9</sup>.

This preclusion has been challenged by the public comments received in response to the PDD. The contention was whether the preclusion to beneficial owner is only limited to a conduit, nominee and agent which could not possibly encompass all forms of conduit entities.

#### 4.3.5 ALIGNING THE MEANING OF BENEFICIAL OWNER UNDER COMMON AND CIVIL LAW SYSTEMS

The presiding judge, Justice Rip made a firm attempt to align the meaning of beneficial owner under common law and civil law which are the legal systems prevalent in Canada.<sup>10</sup>

##### **Civil law:**

The ownership of property was contemplated under the laws of the Civil Code of Quebec which practices civil law. The Civil Code indicated that in relation to property that one person may be the bare dominium owner ("*nu-propriétaire*") of the property and another person, called the usufructuary, may use and enjoy the use of the property (Prevost, 2008:Paragraph 97).

The usufructuary receives the income from the property as owner of the income and is not accountable to the bare dominium owner for any income.

##### **Common law:**

The common law analysis uses a trust as an example, where the trustees hold the property for the benefit of a beneficiary. The trustee is the legal owner but the beneficiary enjoys the attributes of ownership, possession, use, risk and control of the asset.

---

<sup>9</sup>An expert witness quoted in the case: "*On the other hand, a conduit company cannot normally be considered to be the beneficial owner of the income received if it has very narrow powers, performs mere fiduciary or administrative functions and acts on account of the beneficiary (most likely the shareholder). In the view of OECD, such a company has only title to property, but no other economic, legal or practical attributes of ownership* (Prevost, 2008:Paragraph 58)."

<sup>10</sup> "*Civil Code, article 1120. The usufructuary receives the income from the property as owner of the income. He or she is not accountable to the bare owner for any income. That person is similar to the "beneficial owner" in common law of the income* (Prevost, 2008:Paragraph 97)."

In support of his legal analysis, Justice Rip attempted a definition to beneficial owner:

*“In my view the “beneficial owner” of dividends is the person who receives the dividends for his or her own use and enjoyment and assumes the risk and control of the dividend he or she received. The person who is beneficial owner of the dividend is the person who enjoys and assumes all the attributes of ownership. In short the dividend is for the owner's own benefit and this person is not accountable to anyone for how he or she deals with the dividend income (Prevost, 2008:Paragraph 100).”*

#### **4.3.6 BENEFICIAL OWNERSHIP IDENTIFIED IN ACCORDANCE WITH ATTRIBUTES OF OWNERSHIP**

Justice Rip’s view with regard to the beneficial owner being the person that assumes “*all the attributes*” of ownership is debatable because this expression implies all instances of ownership. In contrast to this statement, Du Toit demonstrates that a beneficial owner is the person whose ownership attributes outweighs those of any other person (Du Toit, 2010:P507).

In its final decision, Prevost identified “*possession*”, “*use*”, “*risk*” and “*control*” as attributes of ownership. These ownership attributes were identified in the Canadian dispute of Fortin & Moreau Inc which was held down prior to the decision of Prevost (refer 2.6.2). The judiciary does not indicate if all these elements should be present when establishing the beneficial owner, nor does it indicate an outcome if these elements of ownership are split between various parties (Du Toit, 2010:P507). The established attributes of ownership in Prevost clearly has merit but is not a conclusive definition to the concept.

#### **4.3.7 PIERCING THE CORPORATE VEIL AND ITS RELEVANCE TO BENEFICIAL OWNER**

The Court further examined the legal concept of piercing the corporate veil in a corporate structure and held the following:

*“When corporate entities are concerned, one does not pierce the corporate veil unless the corporation is a conduit for another person and has absolutely no discretion as to the use or application of funds put through it as conduit, or has agreed to act on someone else's behalf pursuant to that person's instructions without any right to do other than what that person instructs it, for example, a stockbroker who is the registered owner of the shares it holds for clients.”*

There was no evidence in Prevost that the dividends paid to PHBV were destined for Volvo and Henlys in the form of a predetermined flow of dividend payments (Singh & Kataria, 2012:P136). Consequently, the test of piercing the corporate veil is superfluous for the purposes of establishing Henlys and Volvo as beneficial owners.

#### **4.3.8 SUBSTANCE OVER FORM DOCTRINE**

The facts of Prevost were compared to Indofood. PHBV did not qualify as a conduit whereas SPV 2 in Indofood was found to be a conduit entity and therefore did not qualify as the beneficial owner. Prevost had a legalistic approach to the facts where the legal meaning of beneficial owner was considered with reference to legislative acts as well as judicial precedents. In contrast Indofood practically considered the facts of the case and concluded that SPV 2 did not qualify as the beneficial owner.

#### **4.3.9 BENEFICIAL OWNER ACCORDED WITH AN INTERNATIONAL FISCAL MEANING**

The Canadian Court analysed beneficial owner from various sources taking into account the OECD Model, principles of the VCLT as well as domestic law in the relevant countries of Canada and the Netherlands. Due to the diverse aspects considered, Prevost would be a good case to draw from to tailor an international fiscal meaning to beneficial owner.

### **4.4 SIGNIFICANT OUTCOMES OF VELCRO**

#### **4.4.1 SUMMARY OF FACTS**

The crisp question in Velcro was whether Velcro Industries BV Netherlands Antilles (“VIBV”) or Velcro Holdings BV Netherlands (“VHBV”) was the beneficial owner of the royalty payment received from Velcro. Velcro initially paid royalties to VIBV in terms of a licensing agreement while the company was a resident of the Netherlands.

VIBV subsequently became a resident of the Netherlands Antilles where Canada did not have a treaty in place and therefore the licensing agreement was assigned to VHBV by way of an assignment agreement. In exchange for the rights granted under the assignment agreement, VHBV agreed to pay VIBV approximately 90% of net sales of the royalty payments received from Velcro. In its final decision, the judiciary held that VHBV was the beneficial owner of the royalty payment.

#### 4.4.2 SUBSTANCE OVER FORM DOCTRINE

VHBV had the legal right to receive the royalty payment from Velcro as well as the exclusive possession and control of the monies.

The following facts of the case support that VHBV was the beneficial owner of the royalty payments:

- The monies received earned interest and were held together with other monies in bank accounts held in the name of VHBV. This was an indicator that the Netherlands entity had discretionary use of the funds.
- The monies received were also exposed to foreign currency risk which was for VHBV's account when payments were effected to VIBV (Kruger, 2012:P12).
- The royalty payments were treated as assets listed on VHBV's financial statements, making them available to creditors and therefore part of the operating activities of the Netherlands entity (Kruger, 2012:P12).
- In addition, the royalty payments received from Velcro was different from the amount paid by VHBV to VIBV (Kruger, 2012:P12).

#### 4.4.3 RELEVANCE OF THE DECISION IN PREVOST TO VELCRO

Due to the similarities in the facts of the cases, Velcro relied heavily on the decision relayed in Prevost<sup>11</sup>. Velcro applied the ownership attributes drawn from Prevost to the facts of the case which were: possession, use, risk, and control (Kruger D, 2012:P10).

The Court demonstrated that the corporate veil is not to be pierced unless the corporation has absolutely no discretion with regard to the use of the funds. The judiciary held that VHBV had possession, risk and control of the royalty payments and therefore qualified as the beneficial owner of the royalty payments.

---

<sup>11</sup> Velcro referred to Prevost: "That case defined a 'beneficial owner' of income as the person who receives the income for his or her own use and enjoyment, and assumes the risk and control of the income he or she received".

## 4.5 SIGNIFICANT OUTCOMES OF A/AS

### 4.5.1 SUMMARY OF FACTS

A Danish bank entered into a swap arrangement with counterparties in the UK, Germany, France and the USA on equity baskets involving Swiss equities. In order to hedge the swap positions the bank acquired the corresponding amount of the underlying Swiss equities. A dividend was paid to the Danish bank in respect of the Swiss equities which were subject to Swiss withholding tax. The Danish bank (shareholder of the Swiss equities) asked for a refund under the Denmark-Switzerland income tax treaty of 1974, which at that time provided for a full refund of the withholding tax.

The Swiss Federal Tax Administration (“SFTA”) denied the refund, arguing that because it entered into the SWAP transactions, it was obliged to pass on the Swiss dividends to the counterparties. As a consequence, SFTA argued that the bank lost beneficial ownership of the shares and committed treaty abuse. The Tribunal decided in favour of the Danish Bank who qualified as the beneficial owner of the dividends.

### 4.5.2 BENEFICIAL OWNER AS A TOOL TO ADDRESS TREATY SHOPPING

The Tribunal explicitly stated that beneficial owner is a concept used as a tool for treaty shopping (Arnold, 2012:P3). The concept also acts as a preventative measure to intermediate structures such as conduit entities that are formed with the express purpose of avoiding withholding tax. The Tribunal further pointed out that the concept is meant to be a condition for entitlement rather than a singular anti-avoidance measure.

In this respect the judgement of the Tribunal reads:

*“One has to bear in mind, though, that the concept of beneficial ownership has been incorporated into the OECD-MC for the purpose of preventing ‘treaty shopping’. Ultimately the idea was to prevent persons not eligible for Convention advantages from enjoying those advantages by means of middlemen or intermediate structures. Seen in its proper perspective, however, the concept of beneficial ownership is merely a condition of entitlement like, say, the concept of residence, rather than a singular abuse clause. Only once all the conditions of entitlement under a DTC are met (including beneficial ownership) does the question of potential abuse of the Convention arise (A/AS, 2012:Paragraph 3.4.3).”*

### **4.5.3 CONTRACTUAL OR FACTUAL OBLIGATION TO PASS ON DIVIDENDS**

The Swiss Tribunal questioned whether the Danish bank was obliged to transfer dividend income to their counterparties under the swap agreement. The Tribunal held that the Danish bank was obliged to make payment to the counterparties in terms of the swap agreement irrespective and independent of the dividend income received in respect of the equities. There was no obligation on the Danish bank to pay an amount equal to the dividend income that it received in respect of the Swiss equities. Consequently, the Danish Bank qualified as the beneficial owner of the dividend income. This case is open to appeal (Arnold, 2012:P6).

## **4.6 OBSERVATIONS**

### **4.6.1 GENERAL OBSERVATIONS**

Collectively, the analysis of each case includes and is not limited to, interpretations of the OECD Model, following the principles demonstrated in the VCLT, examining the meaning of the concept in different languages, applying the substance over form doctrine as well as having regard to the interpretation of the beneficial owner under the principles of civil law and common law systems.

### **4.6.2 EFFECT OF DIVERSE LANGUAGES ON THE INTERPRETATION OF BENEFICIAL OWNER**

#### **Contrast of different languages across the four cases**

The treaty in Indofood was translated into the languages of Indonesia, Netherlands and English (Indofood, 2006: Editor's notes). Curiously, the language factor in Indofood was not examined in the detail that it deserved. Each language may have had its own effective interpretation to the concept of beneficial owner. A direct translation of beneficial owner into the Indonesian language is "*menguntungkan pemilik*" (Google translate, 2012). The Dutch interpretation is "*uiteindelijk gerechtigde*" which translates into ultimately entitled. However the English language prevailed in the judicial decision over the Dutch and Indonesian languages because the case was last heard in the UK Court of Appeal.

Prevost and Velcro are Canadian cases where the language of English and French are prevalent. The contracting party to the treaty was based in Netherlands where Dutch is practiced. Prevost examined the meaning of beneficial owner in various languages of Dutch



French and English. The French version of beneficial owner is “*bénéficiaire effectif*” which means real beneficiary where the Dutch translation was “ultimately entitled” (Prevost, 2008: Paragraph 68). Each contracting party to the treaty in the above two cases had a different translation to the same term that is meant to be commonly understood.

Switzerland was a contracting country in the A/AS case where the judiciary did not consider the languages either. The Swiss version of beneficial owner is “*nutzungsberechtigter*” which translates into English as “entitled to use” (A/AS, 2012:Paragraph 3.4.3).

### **Concluding observation of different languages**

There appears to be a difference in the translation of the same term “beneficial owner” across the various languages of different countries. Nevertheless there are common aspects across the various permutations of the concept, particularly with the phrase “entitled to” and a reference to “real beneficiary” which contributes towards the intended meaning of the concept. In the absence of a unanimous understanding of beneficial owner, a constructive definition needs to be tailored that is commonly understood by all parties to a treaty.

### **4.6.3 IS DOMESTIC LAW INEFFECTIVE TO THE INTERPRETATION OF BENEFICIAL OWNERSHIP?**

#### **Contrast of the use of domestic law across four cases**

The domestic law of Indonesia was not given much attention in Indofood and the judgment was delivered in the UK, a common law jurisdiction (Baker, 2007:P23). In contrast, Prevost considered the domestic meaning of beneficial owner in the Canadian Income Tax Act and case law of Canada (refer 4.3.3). The Act did not contain a definition, although the decision of the Jodrey case did attempt to define the concept. Velcro’s decision did not consider the domestic meaning of beneficial owner in Canada (Arnold, 2012:P2). This was surprising particularly because beneficial owner is contained in several provisions of the Canadian Income Tax Act. A/AS did not consider the domestic meaning either. The judgment was also relatively brief in contrast to the former three cases.

#### **Concluding observation of domestic law across four cases**

The above cases dealt with beneficial owner in relation to treaty benefits and were not domestic disputes in the respective countries. In conclusion, it appears as if domestic law

does not hold wide appeal in foreign courts in respect of disputes relating to treaties. This does not necessarily mean that domestic law is ineffective because it is a good starting point to establish how various jurisdictions interpret beneficial owner as evidenced in Chapter 2. Also Article 3(2) of the OECD Model supports a domestic meaning given to a term that is not defined in a treaty unless the context indicates otherwise. It should be noted that Prevost did consider the meaning of beneficial owner in the domestic dispute of the Jodrey case (refer 4.3.3). In addition the courts of Canada (Prevost and Velcro) and the UK (Indofood) do contain case law from a domestic law perspective in relation to beneficial owner. Many of the concepts/principles and expressions emerging from the selected cases are found in the domestic laws of various countries, for example: the substance over form doctrine and the preclusion of conduit or similar entities from qualifying as a beneficial owner. In addition the similarities across expressions like “real or true owner”, “possession”, “risk”, “use” and “control” “his or her own use and enjoyment” are also found in domestic law of various countries. It is however understandable that domestic law is not often used in treaty disputes given that the policy aims of domestic law and treaties differ which impacts the interpretation of the concept (Avery Jones, Wheeler, 2011:P6).

#### **4.6.4 IMPACT OF COMMON LAW VERSUS CIVIL LAW ON BENEFICIAL OWNER**

##### **Contrast of legal traditions across four cases**

Courts in different legal traditions adopt different approaches to the interpretation of treaties. Indofood was a civil dispute which was heard in the courts of the Netherlands and Indonesia, typically countries which follow the civil law system. The final decision of Indofood was detailed and was pronounced in a common law court of the UK.

Justice Rip analysed the facts of Prevost under a common law and civil law approach. These approaches were used because Prevost was incorporated under the civil laws of Quebec. Most of the territories in Canada operate under common law which was applied by the Canadian Tax Court. Velcro derived its conclusion mainly from the principles applied in Prevost (Kruger, 2012:P12).

The decision of A/AS was held in Switzerland, where civil law is practiced. The ultimate conclusion was legalistic and the analysis of the facts was brief and not as detailed the former three cases which were concluded in common law courts (Arnold, 2012:P3).

### **Concluding observation of legal traditions across four cases**

It appears that the concept received more analysis in common law courts which is expected given that beneficial owner arose out of the common law of UK. Given that beneficial owner is a common law concept, it would not arise as often in the courts of civil law jurisdictions. Also, civil law jurisdictions apply and rely on written codifications of legislation where judicial decisions are not regarded as the prevailing law (Hertel, 2009:P129). This is highlighted by the legalistic approach to the decision of the A/AS case (Arnold, 2012:P3). The study of the concept in Brazil Russia and China (Chapter 2) also indicates that beneficial owner is not that well recognised in civil law jurisdictions.

### **4.6.5 SUBSTANCE OVER FORM DOCTRINE**

#### **Contrast of the substance over form doctrine across four cases**

There are two possible philosophies for interpreting beneficial owner. The first school of thought would be to interpret the concept in a strictly legal sense. The second option would be to obtain a more practical interpretation of the concept by applying the substance over form doctrine.

Indofood is an example for adopting the substance over form doctrine, which prevailed in the final outcome (Singh & Kataria, 2012:P136). The UK Court of Appeal considered the actual facts and circumstances of the case and did not limit its analysis to a technical and legal approach. Despite the fact that the decision was heard in a common law court, Prevost followed a more technical and legalistic approach where attributes of ownership was the central theme. Velcro considered the practical facts of the case. The court evidenced that VHBV had the right to control the funds it had received from Velcro. A/AS had a strong focus on the contractual obligation of the Danish Bank to make payment to the counterparties (Arnold, 2012:P3).

#### **Concluding observation of the substance over form doctrine across four cases**

Foreign courts utilised the substance over form doctrine to obtain an understanding of beneficial owner where the economic realities of a transaction overrides the legal form in a given set of facts. However the legal implications of understanding a term such as beneficial owner are also important. It should be noted that the principles of the doctrine is usually broadly understood and based on the unique factual circumstances of the respective case at

hand which is open to interpretation and could lead to uncertainty (Indofood, 2006:Paragraph 44). Also, treaties are usually drafted and often approached from a technical and legal perspective which to some extent is standardised and therefore it does not necessarily support the factual circumstances of a mutually exclusive case (Baker, 2007:P10).

#### **4.6.6 THE IMPORTANCE OF CONTRACTUAL OBLIGATIONS TO BENEFICIAL OWNER**

##### **Contrast of contractual obligations across four cases**

In Indofood, SPV2 was contractually obligated to pay over the interest payment to the investors one day after it received the funds from Indofood. The payment received by SPV 2 was identical to the interest paid to the loan investors. SPV2 had no discretion to use the funds for its own use. Prevost and Velcro both had a contractual obligation to make payment to PHBV and VHBV respectively in terms of an agreement with the parent entity (Kruger 2012:P13). Both entities had discretionary rights to pass on a percentage of a stipulated amount that was unrelated from the payments received from their respective parent entities. In the A/AS case, the Danish Bank was obligated to pay the counterparties of the swap a dividend irrespective if the bank received a dividend on the Swiss equities that it had acquired (Arnold, 2012:P3). The Danish Bank had sole discretion to use the dividends proceeds that it received on its investment in Swiss equities, for other purposes. Consequently the Danish Bank made a specific payment to its counterparties which it would have had to pay irrespective if it had received dividends on the Swiss equities.

##### **Concluding observations of contracting obligations across four cases**

There appears to be a distinction made between the contractual obligation pass on a payment that is related to the payment received as opposed to a payment that is unrelated to the payment received. Indofood is an example of where the payment received from the parent is related to the obligation to make payment to the investors. The remaining three cases, the recipient was obligated to make payment that was unrelated to the amounts received. This conclusion with respect to a related versus an unrelated payment has been referred to in the revised proposals released by the OECD in October 2012 (refer 3.2.9). It would therefore appear that certain elements concluded in the above cases are finding their way into the OECD Model.

#### **4.6.7 IS BENEFICIAL OWNER A GENERAL OR SPECIFIC ANTI-AVOIDANCE RULE?**

##### **Contrast of the anti-avoidance rules across four cases**

The Courts in the above selected cases do not specify if beneficial owner is meant to be a general or specific anti-avoidance provision. The focus in the selected cases was to identify a beneficial owner which in itself acts as tool for preventing treaty shopping. In Indofood, the judiciary concluded that SPV 2 was a conduit and denied the favourable withholding tax rate in respect of the interest paid to the investors. Prevost and Velcro were more specific in identifying a beneficial owner because they had a legalistic approach to the facts in each case. They concluded that the attributes of ownership such as possession, risk, use and control should be present when identifying a beneficial owner. The decision in A.A/S is quite vague with regard to whether beneficial owner is meant to be a specific or general anti-abuse provision.

##### **Concluding observation regarding treaty abuse across four cases**

In conclusion beneficial ownership, when applied strictly on its own is restrictive as a mechanism to combat treaty abuse. It is however debatable whether it is meant to be a general or specific anti-avoidance provision.

#### **4.6.8 BENEFICIAL OWNERSHIP ACCORDED WITH AN INTERNATIONAL FISCAL MEANING**

##### **Contrast of how each case considered an international fiscal meaning**

Indofood was the presiding case to call on an international fiscal meaning for beneficial owner. The Court decided that the term should not take a meaning dictated by the domestic law of a specific country which in this case was the UK (Baker, 2007:P23). This is understood to mean that the term should have a uniformed meaning across all countries, and not vary from one country to another (Baker, 2007:P23).

Prevost considered possible meanings to beneficial owner in various languages and legal systems, yet did not achieve a consistent definition across all countries. The case did however identify certain attributes of ownership that will aid in identifying a beneficial owner. Velcro

applied similar principles to Prevost. AA/S's decision was fairly brief and did not refer to an autonomous or international fiscal meaning.

### **Concluding observation regarding treaty abuse across four cases**

As evidenced from the above cases, beneficial owner is a widespread term used in many DTA's across different countries. In view of the conflicting interpretations that arose out of the above cases, the concept requires a consistent international fiscal meaning that is commonly understood by all interested parties.

## **4.7 CONCLUSION**

Collectively the selected cases provided insight into considering various aspects regarding the identity or meaning of beneficial ownership in a treaty context. Various courts and tax administrations employed different legal systems, languages, the VCLT, Articles of the OECD Model, domestic interpretations in various countries as well as the substance over form doctrine in the proceedings to establish a meaning to beneficial owner. The above cases have also considered certain attributes in relation to providing a meaning to beneficial owner which appear in the following expressions: "right to enjoy", "ultimately exercise the rights of ownership", "possession", "use", "risk", "control", "his or her own use and enjoyment" and "the person who receives the income for his or her own use and enjoyment". Although none of the courts have managed to define the concept, there has been a determined reference to provide an international fiscal meaning to the concept in a treaty context. Many of the expressions and elements identified in the above treaty cases appear to coincide with the domestic law of the selected countries in Chapter 2. As a result of the diverse factors and common principles/expressions that have been considered, international case law is a valuable source of information to the domestic interpretation of beneficial owner within South African DT legislation.

## **CHAPTER 5: BENEFICIAL OWNER FROM A SOUTH AFRICAN PERSPECTIVE**

### **5.1 INTRODUCTION**

The purpose of this chapter is to examine the interpretation of beneficial owner from a South African perspective and establish the relevance of an international interpretation on SA's domestic use of the term in Income Tax Legislation. Beneficial owner was introduced into the South African DT legislation in April 2012 following the repeal of the STC legislation. The newly enacted legislation impacts recipients who qualify as a beneficial owner according to the laws of SA as well as the international DTAs concluded with SA. This chapter will address the interpretation of beneficial owner in SA's domestic law from subsection 5.2 to 5.4. Beneficial owner in South African treaties will be addressed in subsection 5.5 followed by the significance of an international meaning and concluding remarks.

The scope of this chapter will cover:

- The relevance of the South African legal system to beneficial owner.
- Ordinary meaning of beneficial owner in SA.
- Beneficial owner in the domestic law of South Africa.
- Beneficial owner from a South African treaty perspective.
- The significance of international meaning to the South African interpretation of the concept.

### **5.2 RELEVANCE OF THE SOUTH AFRICAN LEGAL SYSTEM**

South African law operates under a hybrid or mixed legal system. The South African legal system constitutes a mix of civil law system inherited from the Dutch, common law inherited from the British and customary law inherited from indigenous Africans (IBFD, 2012). From a tax perspective, SA operates mainly under a common law approach.

The South African common law applies the substance over form doctrine to determine the true nature of an arrangement (SARS, 2012: P4). Where a court finds that the substance of the transaction differs from the legal form, it will give effect to the substance. Thus, the doctrine prescribes a split of ownership between the recipient that holds the legal title and the recipient that enjoys the right of use of the property or income. On this basis the beneficial

owner would be the recipient that enjoys the right of use of the property or income. This is similar to the principles and concepts outlined in the domestic law of the UK, USA and Canada (Refer Chapter 2).

### 5.3 ORDINARY MEANING GIVEN TO BENEFICIAL OWNER IN SA

Beneficial owner is contained in the ITA as well as various other Acts in SA which is discussed hereunder. The preamble of Section 1 of the ITA contains a general interpretation provision which specifies that a meaning attributed to a text or phrase must be given the definition that is provided in the respective section of the ITA, unless the context indicates otherwise. This appears to align with the intended application of the rules of interpretation according to Article 3.2<sup>12</sup> of the OECD Model and the VCLT<sup>13</sup> that are applied to treaties. Should a provision in the ITA reasonably have two different interpretations, South African law applies the “*contra fiscum*” rule and interprets the provision in favour of the taxpayer (Dison, No date:P164).

According to the judiciary in *Zantsi v Chairman, Council of State, Ciskei, and Others 1995 (2) SA 534 (Ck)*, a significant rule of interpretation in the Constitution is that words should be given an ordinary meaning. This aligns to Article 31 of the VCLT that requires a treaty to be interpreted in good faith in accordance with the ordinary meaning to be given to terms of the treaty.

Dictionaries are often used in courts to support the interpretation of an ordinary meaning given to a word or phrase (*Secretary for Inland Revenue v Charkay Properties (Pty) Ltd 1976 (4) SA 872 (AD)*). The ordinary meaning given to beneficial owner according Black Laws Dictionary (1990) reads:

*“One who does not have title to property but has rights in the property which are the normal incidents of owning the property. The persons for whom a trustee holds title to the property*

---

<sup>12</sup> Article 3(2) of the OECD Model reads: “As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.”

<sup>13</sup> Article 31 reads: “A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to terms of the treaty in their context and in the light of its object and purpose.”



*are beneficial owners of the property, and the trustee has a fiduciary responsibility to them”* (Arnold, 2010, P502).

The interpretation understood from the dictionary coincides with the principles of the substance over form doctrine.

## **5.4 BENEFICIAL OWNER IN THE DOMESTIC LAW OF SOUTH AFRICA**

### **5.4.1 BENEFICIAL OWNER IN THE SOUTH AFRICAN ITA**

Section 64D (DT) reads:

*“beneficial owner means the person entitled to the benefit of the dividend attaching to a share”.*

The focus of this definition is on “entitlement to a benefit”. Entitlement is usually associated with “rights” to something, given its ordinary interpretation and in this respect it would be associated with a dividend. The phrases “entitlement to a benefit” and “right” to something appears to be similar in meaning to the expression identified in the domestic laws of UK, USA and Canada (Refer Chapter 2).

A simplistic example of this would be where the shareholder qualifies as the beneficial owner of the dividend by virtue of holding shares directly in a company. In this instance the legal title to the shares as well as the rights to receive the dividend is assumed to rest with the same person.

The situation is more complicated where there is a split of ownership between the legal owner of the share and recipient that receives the dividend income in respect of the same share. The recipient that receives the dividend income would qualify as the beneficial owner of the dividend which is distinct from the legal owner of the share.

Presumably a benefit in relation to a share would refer to the dividend attached to a share. A beneficial owner is not required to be the owner of such share. Hence, to qualify as a beneficial owner, a recipient is required to be entitled to the rights attached to a dividend.

Beneficial owner is fairly new in the ITA and therefore there is no case law to demonstrate this principle from a South African case law perspective. The concept has received a lot of

attention in international courts as discussed in Chapter 4. The relevance of foreign judicial precedents to beneficial owner in SA is discussed in 5.6.3.

Except for the section 64D, the closest phrase to beneficial owner in the ITA is beneficiary in Section 1 which is in relation to a trust. Beneficial owner originated as a trust law concept under the common laws of the UK and it would therefore be useful to assess the meaning against beneficiary (refer 2.4).

Section 1 reads:

*“beneficiary in relation to a trust means a person who has a vested or contingent interest in all or a portion of the receipts or accruals or the assets of that trust.”*

The crisp question is whether a beneficiary satisfies the definition of beneficial owner. Fundamentally, beneficiary is intended to qualify as a beneficial owner particularly in view of the fact that the concept arose from trust law. However, beneficiary in terms of section 1 refers to a person who has a “vested” or “contingent” right, which may be a point of distinction.

In terms of the South African law, a trustee is obligated to make a payment to a beneficiary that has a vested interest to the receipts or accruals or capital of the respective trust. There is no discretion that must be exercised by the Trustees of the trust in respect of the obligation arising out of the vested interest. The Trustees are obliged to make the vested payment to the beneficiary. Hence, it is submitted that a beneficiary that has a vested interest to the receipts or accruals or capital of the trust would qualify as the beneficial owner of that interest.

In contrast, a Trustee does have the discretion to make payment to a beneficiary that has a contingent right to the receipts or accruals or the assets of the trust. The Trustees in this instance are not obligated to make a payment to the beneficiaries and therefore in such an instance, a beneficiary would not qualify as a beneficial owner.

According to this provision, it would appear that the Trustee must be obligated to make payment to a beneficiary in order for the beneficiary to become entitled to the payment and therefore qualify as a beneficial owner. This is similar to the principles identified in Indofood (Refer 4.2.4).

## 5.4.2 BENEFICIAL OWNER IN OTHER SOUTH AFRICAN LEGISLATION

### 5.4.2.1 The Uncertificated Securities Tax Act No. 31 of 1998 (“UST Act”)

The UST Act includes:

*“Beneficial ownership in relation to a security, includes any one or more of the following:*

- (a) The right or entitlement to receive any dividend or interest payable in respect of that security; or*
- (b) The right to exercise or cause to be exercised in the ordinary course of events, any or all of the voting, conversion, redemption or other rights attaching to such security.”*

The UST Act, now repealed, prescribed uncertificated securities tax in the event of a transfer of a security. The definition provided in the UST Act made strong reference to phrases of “right” attached to the dividend or “rights” associated with a share as well as “entitlement” to a dividend. This is similar to the decision in Prevost.

### 5.4.2.2 The Securities Transfer Tax Act of 2007 (“STT Act”)

The STT Act was implemented on 1 July 2008 and replaced the previous UST Act. The STT Act prescribes securities transfer tax in the event of a transfer of a security. The STT Act does not contain a definition of beneficial ownership like the UST Act. SARS however refers to the interpretation of “transfer”<sup>14</sup> with reference to beneficial ownership when securities transfer tax is a potential liability to a recipient (SARS, 2012).

### 5.4.2.3 Companies Act No. 71 of 2008 with its regulations (“Companies Act”)

The phrase closest to beneficial owner in the Companies Act is beneficial interest under Section 1 which reads:

*“Beneficial interest, when used in relation to a company’s securities, means the right or entitlement of a person, through ownership, agreement, relationship or otherwise, alone or together with another person to –*

- (a) receive or participate in any distribution in respect of the company’s securities;*
- (b) exercise or cause to be exercised, in the ordinary course, any or all of the rights attaching to the company’s securities; or*

---

<sup>14</sup> “transfer includes the transfer, sale, assignment or cession, or disposal in any other manner, of a security or the cancellation or redemption of that security, but does not include—

(a) any event that does not result in a change in beneficial ownership (SARS, 2012).”

*(c) dispose or direct the disposition of the company's securities, or any part of a distribution in respect of securities".*

Like the UST Act, the definition provided in the Companies Act refers to the phrases "right" and "entitlement" of a recipient in respect of a distribution received from a company as well as rights attaching to a company's securities. This is similar to the concepts/principles stated in the UK, USA and Canada.

### **5.4.3 SA'S INTERPRETATION OF BENEFICIAL OWNER IN ENACTED LEGISLATION**

There does not appear to be a common definition of beneficial owner in SA's legislation. Section 64D of the ITA refers to "entitlement to a benefit" whereas Section 1 of the ITA refers to "vested or contingent interest" in relation to the concept. The UST Act and Companies Act refers to "rights" or "entitlement" in relation to income or an asset when considering beneficial owner. There appears to be common aspects amongst the phrases "right" and "entitlement" in respect of income or assets in SA's domestic law. Despite the absence of a uniform interpretation, the common aspects are indicative of SA aligning their domestic legislation.

## **5.5 BENEFICIAL OWNER IN SOUTH AFRICAN TREATIES**

### **5.5.1 SIGNIFICANCE OF THE "RESIDENT" CONCEPT TO BENEFICIAL OWNER**

The subset of this chapter will only deal with beneficial owner as it appears in the dividend Article 10 of South African treaties. As a prelude to assessing the treaties and its relation to DTA's, it is important to consider the relevance of a resident to beneficial owner. SA operates under a resident<sup>15</sup> based income tax system and it is therefore a fundamental concept in South African tax (Haupt, 2012:P428). If the beneficial owner company is a non-resident, it may qualify for a favourable DT rate if there is a DTA between SA and the country of residence for the non-resident (Haupt, 2012:P428).

---

<sup>15</sup> According to Section 1 of the ITA, SA determines the residency of a legal person (example of a company) with reference to if it is incorporated, established or formed in SA or whether the company has its place of effective management in SA (irrespective of where it is incorporated, established or formed). If the company is deemed to be a resident of another Contracting State in terms of a DTA, the company will also be deemed to be a resident in that Contracting State for purposes of the ITA.

Resident is usually used in conjunction with beneficial owner in the wording of a Dividend Article in a DTA. The wording of a Dividend Article commonly refers to a dividend paid to a resident of the Other Contracting State if the resident is a beneficial owner of the dividend. By inference, a beneficial owner is required to be a resident of the other Contracting State to qualify for a favourable withholding tax rate.

### **5.5.2 RELEVANCE OF DT TO BENEFICIAL OWNER IN SOUTH AFRICAN TREATIES**

DTAs are instruments of international law. According to the old rule “*Lex specialis derogat legi generali*” (“special legislation overrides general legislation”), treaties override the domestic tax law that is effective at the time of their implementation (Vogel, 2006, P2).

Where a dividend subject to DT is paid to a recipient other than an exempt entity<sup>16</sup> or regulated intermediary<sup>17</sup>, DT of 15% is levied on such dividend unless the rules applicable to a DTA apply. DTAs usually provide that dividends paid by a company resident in a Contracting State where the beneficial owner is a resident of another Contracting State, may be taxed in the latter state where the tax rate is usually lower than the DT rate of 15% (SARS, 2012). Essentially, dividends paid to non-residents of SA may be subject to DT at a lower rate, where treaty rules apply. However, if the DTA specifies a rate of DT which is higher than 15%, the beneficial owner will only be liable for the 15% DT.

### **5.5.3 RELEVANCE OF DOMESTIC LAW TO THE INTERPRETATION OF BENEFICIAL OWNER IN A TREATY CONTEXT**

In a treaty context Article 3(2)<sup>18</sup> of the OECD and UN Models support a domestic meaning given to a term that is not defined<sup>19</sup> in a treaty unless the context indicates otherwise. The practical advantage of supporting a domestic meaning is that it increases the legal certainty of interpreting an undefined term such as beneficial owner, because taxpayers, administrative

---

<sup>16</sup> Section 64F

<sup>17</sup> Section 64D

<sup>18</sup> “As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.”

<sup>19</sup> Beneficial owner is a term that is not defined in the OECD and UN Models and is contained in numerous treaties that do not define the concept.

authorities and courts can maintain and rely on the meaning of the term that they know from their respective country's domestic legislation (Olivier & Honiball, 2008: P45).

However an obvious negative consequence of referring to domestic law in a treaty context is that in many instances, two contracting parties (countries where domestic law differs) to a treaty can attach different meanings to the same term (Kandev, 2007:P38). This is understandable given that domestic law<sup>20</sup> has different policy aims to that of treaties which is a contributory factor to an inconsistent interpretation to a term like beneficial owner (Avery Jones, Vann, Wheeler, 2011:P6).

One of the key points proposed by the OECD to the Commentaries to Article 10, is that the concept should not be constrained by the legal technical meaning given by the domestic law of the respective country (refer 3.2.7.1). Furthermore the OECD indicated that domestic law is not irrelevant because it may provide assistance to the interpretation of beneficial owner in a treaty context.

Case law in many instances forms part of domestic law of many countries (Steyn & Reitz, 2010:P4). The case law discussed in Chapter 2 largely deals with beneficial owner in a domestic context. Many elements and expressions of the meaning given to beneficial owner in the domestic context have been used as a precedent in disputes involving treaty benefits (Refer 2.11.4). Accordingly, the interpretation in domestic law is useful to the interpretation of the concept in a treaty context in SA.

#### **5.5.4 BENEFICIAL OWNER IN SELECTED SOUTH AFRICAN TREATIES**

South Africa's tax treaty network is composed of 82 treaties of which 22 are concluded with African countries and 60 with the rest of the world. The words beneficial owner is contained in numerous DTAs that SA concludes with other Contracting States, yet it remains an undefined term within the treaty.

A selection of ten DTAs was selected from the Summary of Treaties provided by SARS as at 1 November 2012 for review with regard to beneficial owner in this chapter. It should be noted that the selection is only a representation of the 82 treaties in effect and therefore not a conclusive account all the treaties in force in SA. None of the DTA's selected contained a

---

<sup>20</sup> Domestic law is said to prevent persons from avoiding taxation by transferring their income to another person while the policy aim of a treaty is to prevent treaty shopping by paying income through a treaty-entitled person (Avery Jones, Vann, Wheeler, 2011:P6).

definition of beneficial owner. In the absence of a definition for the concept, the OECD and UN Models indicate the application of Article 3(2) from which the question arose as to whether the domestic meaning should apply in a treaty context. The findings of the selected DTAs reviewed are detailed hereunder:

#### **Malawi, Zambia, Zimbabwe:**

These treaties were selected on the basis that they do not contain a dividend Article and therefore exclude the concept of beneficial owner. The question in this instance would be whether legal ownership or the domestic definition within SA would apply to the concept in the event that a dividend is paid in a cross-border transaction between SA and the above countries.

In the absence of a dividend Article, there is no treaty benefits associated with dividends paid in cross-border transactions. SA therefore applies the DT rate of 15% to the dividend paid to a resident of Malawi, Zambia or Zimbabwe on the basis that that resident is the beneficial owner of the dividend (SARS, 2012). Based on the application of the DT rules in this instance, it would appear that SA would apply the domestic meaning of beneficial owner to the recipient of a dividend in a cross-border transaction.

#### **UK, USA, Canada and BRIC countries:**

These developed countries were selected on the basis that they are the developed economies in the world and it would therefore be beneficial to examine the concept as it appears in the Dividend Article concluded between SA and developed countries. The BRIC countries were selected because it would be useful to assess the concept as it appears in the DTAs concluded between SA and its peers.

The wording of Article 10 in relation to beneficial owner in DTAs concluded with the UK, USA and Canada are similar in wording except for the conditions that apply to withholding tax rates. The DTAs also provide that the beneficial owner of the dividend must be a resident of the Other Contracting State. Hence, benefits under a treaty will only be applicable if the beneficial owner is a resident of the Other Contracting State which confirms that the concept

is a tool for preventing treaty shopping<sup>21</sup>. If the provisions of Article 3(2) are applied, the treaty would support a domestic interpretation of the concept unless the context indicates otherwise. This usually results in divergent interpretations and therefore the OECD and international case law have motivated that the concept should be given an international fiscal meaning.

## **5.6 THE IMPACT OF AN INTERNATIONAL INTERPRETATION TO SA**

### **5.6.1 SIGNIFICANCE OF DOMESTIC LAW TO THE INTERPRETATION OF BENEFICIAL OWNER IN SA**

Chapter 3 established that developed nations preferred the substance over form doctrine when interpreting beneficial owner. The doctrine allows ownership to be split between the recipient that holds the legal title and the recipient that has the economic right to use the asset or income. This is typically a common law approach which is applied in SA as well. The DT legislation demonstrates that beneficial owner is the person that is entitled to a benefit of the dividend which confers, given its ordinary meaning, rights to the dividend. This interpretation appears similar in meaning to the expression identified in the case law of the UK, USA and Canada.

Like SA, the concept is relatively new in the legislation of the developing countries of BRIC with the exception of India. The key difference is that Brazil, Russia and China operate under civil law systems where the legislation is largely based on codified law. These countries prefer to outline set criteria that will serve to identify a beneficial owner. India operates under a common law system and therefore applies the principles of dual ownership. On further investigation of the BRIC countries, it appears that beneficial owner has been defined with reference to phrases such as “receives the money for his own account” (Brazil), “right to own, use or dispose of income” (Russia) and “person who has the ownership and control right over the income” (China).

Although SA’s ITA definition of the concept is not narrative, it appears to have similar elements to those of developed and developing nations. The similarities identified in the ITA

---

<sup>21</sup> This is inferred from the following extracts from the selected DTAs: “where the recipient is the beneficial owner of the dividends”, “if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed...” and “beneficial owner of such dividends shall be taxable only in that other Contracting State...”.



are indicative of an intended alignment with international tax norms and therefore it may be beneficial for SA to draw on the meaning of the concept from the domestic law of other countries.

#### **5.6.2 THE IMPORTANCE OF THE OECD AND UN MODELS TO SA'S INTERPRETATION OF BENEFICIAL OWNER**

SA is a developing economy and a member country of the UN and therefore uses the UN Model as a framework for treaties. Beneficial owner is a term that is frequently used in numerous bilateral tax treaties that SA concludes with other countries. The UN Model is also a derivation of the OECD Model and is likely to adopt the proposed amendments or developments made by the OECD.

Some of the proposed amendments made by the OECD contain similar concepts and principles to the domestic laws of other countries and appear in international cases like *Indofood*, *Prevost* and *Velcro*, for example the expressions “right to use and enjoy the income” and “constrained by a contractual or legal obligation to pass on the payment received to another person”. The expressions “right to use and enjoy the income” appear similar in the domestic laws of developed and developing countries. Also the preclusion of conduit or similar entities from qualifying as a beneficial owner that is included in the existing Commentaries to Article 10 of the OECD Model appear in certain domestic laws and circulars of the BRIC countries.

SA has numerous treaties currently in effect. The South African treaties selected for review were all concluded in English with a diverse range of countries that practice various languages, legal systems as well as other customs that impact the interpretation of beneficial owner. The inclusion of the concept in a treaty confirms that beneficial owner is a tool for preventing treaty shopping. The absence of a definition in the selected DTA's and the conflicting interpretations that result from the use of various domestic laws indicates that beneficial owner should be accorded with an international fiscal meaning in a treaty context.

Given the diverse audience, the developments and amendments to the OECD and UN Models is intended to accommodate most countries in the world including SA. Therefore the OECD's proposed amendments and the intention to ascribe an autonomous meaning to the concept is intended to be consistently understood by most countries which would include SA (refer 3.2.7). In conclusion, it would appear that the OECD and UN Models would play a

contributory role to the interpretation of beneficial owner in SA, both from a domestic law as well as treaty perspective.

### **5.6.3 RELEVANCE OF INTERNATIONAL CASE LAW TO BENEFICIAL OWNER IN SOUTH AFRICAN COURTS**

SA's tax laws are based on a combination of the South African ITA and case law. Decisions of foreign courts are often quoted in South African courts and used in judicial decisions in SA. The case of *Sub-Nigel Ltd v CIR* 1948 (4) SA 580 (A), 15 SATC 381 indicates that South African tax legislation differs in many respects from the decision relayed in foreign courts and therefore it may be dangerous to follow a different law slavishly. Hence the judgments of foreign courts are not binding in SA but are significant because they have persuasive value to the interpretation of beneficial owner in SA.

Beneficial owner is relatively new in SA and therefore there is not much case law on the concept. Many of the expression identified in the domestic case law of other countries such as "right of the owner to enjoy the fruits of it or dispose of it for his own benefit", "right at least to some extent to deal with the property as your own", "beneficial use", right to its enjoyment", "possession", "use", "risk" and "control and command over property" have found their way into international cases like *Prevost and Velcro*. In addition, the meaning of these expressions is similar to the meaning of beneficial owner in the ITA. Given the similarities, the international case law of *Indofood*, *Velcro*, *Prevost* and *A/AS* as well as other international case law would play a contributory role in tailoring a meaning to beneficial owner in SA.

## **5.7 CONCLUSION**

There are common factors amongst the definitions associated with beneficial ownership in South African legislation. The legislation appears to focus on "rights", "entitlement" and "attributes of ownership" in relation to income or an asset which is similar to the conclusions arrived at in the study of the domestic law of other countries (refer Chapter 3). Despite the absence of a uniform interpretation, the domestic law of SA indicates that there are common aspects across the various Acts in effect (ITA, Companies Act and UST Act) which are indicative of SA aligning its interpretation of the concept.

The laws of other countries may not be directly relevant to SA's interpretation of beneficial owner because different legal systems and practices are applicable in each jurisdiction. Nevertheless, the laws of other countries do however have persuasive value and appear to share similar interpretations with SA's laws. The developments and proposed amendments to Article 10 to the Commentaries of the OECD and UN Models is intended to accommodate most countries in the world which would include SA, particularly in view of the fact that there are many common aspects across the domestic laws of other countries and the Commentaries to the models. Also international case law has persuasive value in SA and would play a contributory role in tailoring an interpretation of the concept in SA. In conclusion, it would be appear that the international interpretation of the concept would be beneficial to the interpretation of the concept's use within SA's DT legislation.

University of Cape Town

## CHAPTER 6: CONCLUSION

### 6.1 INTRODUCTION

The purpose of this dissertation has been to examine and draw out the commonalities or differences of the meaning of beneficial owner in a domestic and treaty (international) context. The common factors identified were assessed for similarities present in the domestic use of the concept within South African DT legislation. The research aimed to draw attention to the briefly defined concept in the DT legislation and where possible draw on international interpretation to support the domestic use of the concept in SA. For the purposes of this dissertation, international interpretation encompassed the following:

- Beneficial owner in Domestic Law
- Beneficial owner in the OECD and UN Models
- Beneficial owner in International Case Law

The scope of this dissertation has been discussed in the preceding chapters with some of the findings supporting the purpose of this research. Below is a summary of the findings pertaining to the research.

### 6.2 BENEFICIAL OWNER IN DOMESTIC LAW

As discussed in Chapter 2, there is no universally accepted interpretation of beneficial owner in the domestic law of the selected countries which leaves the concept open to a flexible interpretation. This study has examined beneficial owner in the domestic legislation of the UK, USA, Canada as well as the developing countries of BRIC.

Focus was placed on the following aspects of domestic law with respect to drawing out the common factors present in the meaning beneficial owner:

- The ordinary meaning of the concept.
- The use of the concept in the tax legislation.
- The usage of the concept in local case law.
- The impact of the use in multi-lingual countries.

Despite the absence of a definitive meaning to the concept, there appears to be a common focus on expressions such as “rights”, “entitlement” and “attributes of ownership” under the domestic laws of the selected countries including SA. Beneficial owner arose as a common law concept in the UK where due regard is given to the recipient that enjoys the rights and attributes of ownership rather than mere legal title which is typically a practice of the substance over form doctrine.

Domestic law appeared to favour the application of this doctrine when determining the beneficial owner. Also, certain countries apply the preclusion of conduit or similar entities from qualifying as a beneficial owner which is very similar to the principles applied in the OECD and UN Models in a treaty context. Despite the absence of a universally accepted interpretation, the similarities and commonalities are indicative that the domestic law of countries are moving towards a similar understanding of the concept and therefore it would be beneficial for SA to draw on this interpretation.

### **6.3 BENEFICIAL OWNER IN THE OECD AND UN MODELS**

The international aspects addressed in the OECD and UN Models highlighted that beneficial owner is an evolutionary concept that has gone through several amendments since its introduction into the international conventions. The OECD and UN Models provide a treaty framework for developed and developing economies respectively. Beneficial owner is not defined in both the OECD and UN Models and is contained in numerous treaties that do not define the concept.

Many countries rely on their domestic interpretation of the concept which varies due to different legal systems, languages and practices based on the findings in Chapter 2. Due to the lack of definition a universal accepted meaning, the concept is open to a flexible interpretation. To this extent the OECD has proposed amendments to the interpretation of the concept which is pending finalisation. One of the key elements emerging from the proposed amendments is that beneficial owner should be given an autonomous/international fiscal meaning that is commonly understood internationally in a treaty context.

The UN Model is derived from the OECD Model and based on previous practice, it is likely to adopt the amendments made by the OECD. SA is a member country to the UN and adopts the UN Model in the conclusion of its treaties. Given that treaties have a diverse audience, the

proposed amendments made by the OECD are intended to accommodate most countries in the world including SA.

#### **6.4 BENEFICIAL OWNER IN INTERNATIONAL CASE LAW**

Various courts across the world have debated the identity and interpretation of beneficial owner in recent years. The international treaty cases of Indofood, Prevost, Velcro and A/AS have been heard in a variety of courts across the world. All four cases were diverse and considered various aspects from different languages and legal systems to domestic legislation and international conventions. Although none of the courts have managed to define the concept, there has been a determined preference to provide an international fiscal meaning to the concept in a treaty context.

Foreign judicial precedents have persuasive value in South African domestic law and therefore it is a valuable source of information to support the domestic interpretation of beneficial owner. There is no case law in SA on beneficial owner in view of its recent enactment into the DT legislation.

The selected treaty cases have considered certain attributes in relation to providing a meaning to beneficial owner which appear in the following expressions: “right to enjoy”, “ultimately exercise the rights of ownership”, “possession”, “use”, “risk”, “control”, “his or her own use and enjoyment” and “the person who receives the income for his or her own use and enjoyment”. The concept was also addressed in international cases from a domestic law perspective in Chapter 2. The findings and expressions in Chapter 4 appear to coincide in some instances with the domestic interpretation of the concept.

#### **6.5 BENEFICIAL OWNER FROM A SOUTH AFRICAN PERSPECTIVE**

This purpose of this chapter was to examine the interpretation of beneficial owner from a South African perspective and establish the relevance of an international meaning on SA’s domestic use of the concept in Income Tax Legislation. Beneficial owner was introduced into the South African DT legislation in April 2012 following the repeal of the STC legislation. The definition of beneficial owner in the DT legislation is quite wide and there is no interpretation note complementing the interpretation of the concept. Despite the absence of a uniform interpretation, common factors have been identified amongst the definitions associated with beneficial ownership in South African legislation. The legislation appears to

focus on “rights”, “entitlement” and “attributes of ownership” in relation to income or an asset which is similar to the conclusions arrived at in the study of the domestic law of other countries (refer Chapter 2).

International case law and domestic law including SA favour the substance over form doctrine. In addition the similarities across expressions like “rights”, “possession”, “risk”, “use” and “control” “his or her own use and enjoyment” that were part of international case law (domestic and treaty) appear similar in meaning to the definition of the concept in the SA’s Income Tax Legislation. These similarities appear in both a domestic and treaty context in spite of the difference in policy aims between domestic law and treaty practices. In conclusion, it would be appear that the international interpretation of the concept would be beneficial to the interpretation of the concept in SA’s DT legislation.

## **6.6 GENERAL**

At a first glance, the various spheres of international interpretation and SA’s interpretation appear to have different meanings to the concept of beneficial owner. The conflicting meanings are understandable given that each country or international convention in relation to treaties have their own policy aims and methods of interpretation that forms part of their distinctive legislative provisions.

However on further investigation and based on the findings in each chapter, it appears that the concept shares many common aspects, principles and expressions from a domestic and treaty perspective which includes the findings of SA. From a treaty perspective, the OECD is currently driving an international fiscal meaning to beneficial owner where commonalities to such meaning are found in the domestic law of the selected countries. The similarities found in domestic law indicate that countries are moving towards a similar understanding of the concept. Despite minor differences, there are more common aspects than differences to the meaning of beneficial owner in both a domestic and treaty context. Therefore in conclusion and in support of SA’s intent to align with international tax systems, it would be valuable to draw on the interpretation accorded to beneficial owner in international tax circles for the purposes of SA’s DT legislation.

## **BIBLIOGRAPHY**

### **CASE LAW**

1. A-6537/2010 of Mar. 7, 2012.
2. Indofood International Finance Ltd v. JP Morgan Chase Bank NA Court of Appeal, 2nd March 2006, (2006) 8 ITLR 653; [2006] STC 1195.
3. Prevost Car Inc v R 2008 TCC 231, affirmed by the Federal Court of Appeal in 2009 FCA 57.
4. Velcro Canada Inc v Her Majesty the Queen, 2012 TCC 57, 24 February 2012.
5. Zantsi v Chairman, Council of State, Ciskei, and Others 1995 (2) SA 534 (Ck).

### **BOOKS**

6. Chynoweth, P. 2008, Legal Research. 1:20.
7. Haupt P, 2012, Notes on South African Income Tax.
8. Olivier, L and Honiball, M. 2008 International Tax.
9. Vogel K, 2006. Tax treaties and Domestic law: The Domestic Law Perspective.

### **DISSERTATION**

10. Du Toit C, 1999. Beneficial Ownership of Royalties in Bilateral Tax Treaties.

### **INTERNATIONAL CONVENTIONS**

11. OECD 2012. OECD Model Tax Convention: Revised Proposals concerning the meaning of “Beneficial Owner” in Articles 10, 11, 12.
12. OECD Model. 2010. Organisation for Economic Co-operation and Development.
13. OECD. 2011. Clarification of the meaning of “Beneficial owner” in the OECD Model Tax Convention.
14. UN Model. 2001. Articles of the United Nations Model Double Taxation Convention Between Developed and Developing Countries .
15. UN Model. 2011. United Nations Model Double Taxation Convention between Developed and Developing Countries.



## ARTICLES

15. Arnold B. 2012. Tax Treaty Case Law News - A Trio of Recent Cases on Beneficial Ownership Bulletin for International Taxation, 2012.
16. Baker, P. 2007. Beneficial Ownership: After Indofood, GITC Review VI
17. Committee of Experts on International Cooperation in Tax Matters. 2010. Concept of Beneficial Ownership: Discussion of key Issues and proposals for changes to the UN Model Commentary, United Nations. E/C.18/2010/CRP.9.
18. Danon, R. 2011. Clarification of the Meaning of “Beneficial Owner” in the OECD Model Tax Convention – Comment on the April 2011 Discussion Draft. Bulletin for International Taxation.
19. Du Toit, C. 2010. The Evolution of the Term “Beneficial Owner” in relation to international tax over the past 45 years.
20. Economic and Social Council Committee of Experts on International Cooperation in Tax Matters Fourth session. 2008. Progress Report of Subcommittee on Improper Use of Tax Treaties: Beneficial Ownership, United Nations. E/C.18/2008/CRP.2/Add.1.
21. Hertel C. 2009. An overview of legal systems. Notarius International 1-2/2009.
22. Institute for Austrian and International Tax Law Vienna. 2012. Conference “Beneficial Ownership”.
23. Jones J, Vann R and Wheeler J. 2011. OECD Discussion Draft “Clarification of the Meaning of Beneficial Owner” in the OECD Model Tax Convention.
24. Krishna, V and Gervais B. 2006. Treaty Shopping and the Concept of Beneficial Ownership in Double Tax Treaties. Canadian Current Tax.
25. Kruger, D. 2012. Who is a Beneficial Owner? Business Tax and Company Law Quarterly 3.
26. Lang M, Pistone P, Schuch J and Staringer C. 2012. The Impact of the OECD and UN Model Conventions on Bilateral Tax Treaties.
27. Rocha, A. 2012. Treaty Shopping and Beneficial Ownership under Brazil’s Tax Treaties, 66 Bulletin for International Tax 7.
28. Singh V and Kataria V. 2012. The OECD’s Amendments to the Beneficial Owner Concept: Thoughts From India Tax Notes International, 65.
29. Yip, F. 2006. Tax feature. U.K. court case on conduit company and “beneficial owner”.

## **SOUTH AFRICAN GOVERNMENT PUBLICATIONS AND LEGISLATION**

- 30. South Africa. 1962. Income Tax Act No. 58 of 1962. Pretoria: Government Printer.
- 31. South Africa. South African Revenue Services. 2010. Draft Comprehensive Guide to the General Anti-Avoidance Rule.

## **SOUTH AFRICAN TREATIES**

- 32. Brazil. 2006. Convention between the Government of the Republic of South Africa and the Government of the Federative Republic of Brazil for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income.
- 33. Canada. 1995. Convention between the Government of the Republic of South Africa and the Government of the Canada for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains.
- 34. China. 2000. Agreement between the Government of the Republic of South Africa and the Government of the Peoples' Republic of China for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income.
- 35. India. 1996. Agreement between the Government of the Republic of South Africa and the Government of the Republic of India for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income.
- 36. Russia. 2000. Agreement between the Government of the Republic of South Africa and the Government of the Russian Federation for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income.
- 37. UK. 2012. Protocol between the Republic of South Africa and the Government of the United Kingdom of Great Britain and Northern Ireland to amend the Convention China for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on Capital Gains, signed in London on 4 July 2002.
- 38. USA. 1997. Convention between the Government of the Republic of South Africa and the Government of the United States of America for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains.

## **ELECTRONIC RESOURCES**

- 39. Britannica. 2012. [Online]. Available:  
<http://www.britannica.com/EBchecked/topic/128386/common-law>. [15 July 2012].

40. Business Dictionary.com. 2012 [Online]. Available:  
<http://www.businessdictionary.com/definition/treaty-shopping.html> . [15 December 2012].
41. Canadian Revenue Agency. 2012. [Online]. <http://www.cra-arc.gc.ca/E/pub/tp/it437r/it437r-e.pdf>. [11 January 2013].
42. Capital Markets Tax Committee of Asia. 2011. [Online]. Available:  
<http://www.oecd.org/tax/taxtreaties/48413629.pdf> [30 May 2012].
43. China Briefing. 2012. China Clarifies the Determination of Beneficial Owners under Double Taxation Agreements. [Online]. Available.<http://www.china-briefing.com/news/2012/07/18/china-clarifies-the-determination-of-beneficial-owners-under-double-taxation-agreements.html>. [20 May 2012].
44. China Tax Update. 2010 China Issued Guidance on the Recognition of a “Beneficial Owner” under Double Tax Treaties. [Online]. Available: <http://www.salans.com/en-GB/Locations/~media/Assets/Salans/Publications/2010/100120%20Salans%20China%20Tax%20Update-%20Issue%20No%2010%20En.ashx> [20 May 2012].
45. Collier R. 2011. Clarity, Opacity and Beneficial Ownership: [Online]. Available: [http://uscib.org/docs/BTR\\_Issue\\_Beneficial%20Ownership\\_Collier.pdf](http://uscib.org/docs/BTR_Issue_Beneficial%20Ownership_Collier.pdf) [20 May 2012].
46. Economic and Social Council Committee of Experts on International Cooperation in Tax Matters Fourth session Geneva. 2008. Progress Report of Subcommittee on Improper Use of Tax Treaties: Beneficial Ownership, E/C.18/2008/CRP.2/Add.1.
47. Economic and Social Council Committee of Experts on International Cooperation in Tax Matters Fourth session Geneva. 2010. Concept of Beneficial ownership: Discussion of key issues and proposals for changes in the UN Model Commentary. E/C.18/2010/CRP.9.
48. Ernst & Young. 2012. Supplementary rule to Circular 601 to add in new considerations for determining beneficial ownership. : [Online]. Available:  
[http://www.ey.com/Publication/vwLUAssets/CTIN2012005\\_en/\\$FILE/CTIN2012005\(ENG\).pdf](http://www.ey.com/Publication/vwLUAssets/CTIN2012005_en/$FILE/CTIN2012005(ENG).pdf). [11 November 2012].
49. Globalization, International Development and World Rankings from a Positive, Comparative Perspective. 2012. [Online]. Available:  
<http://www.globalsherpa.org/bric-countries-brics> [15 July 2012].

50. Google translate. 2012. [Online]. Available  
<http://translate.google.com/?tl=id&q=undefined#auto/id/beneficial%20owner> [20  
November 2012].
51. HMRC 2012. <http://www.hmrc.gov.uk/>
52. HRMC. <http://www.hmrc.gov.uk/manuals/ihmanual/ihtm04441.htm> [Online].  
Available: [17 May 2012].
53. <http://dudiwahyudi.com/pajak/pajak-penghasilan/beneficial-owner.html>. [17 May  
2012].
54. India and China – Looking below the surface to compare these two rising Asian  
business giants. [Online]. Available: [http://www.business-in-](http://www.business-in-asia.com/asia/comparing_china_india.html)  
[asia.com/asia/comparing\\_china\\_india.html](http://www.business-in-asia.com/asia/comparing_china_india.html) [20 May 2012].
55. IBFD, 2012. [Online]. Available: <http://www.ibfd.org/>. [18 November 2012].
56. Kandev, M. 2007. [http://www.fitindia.org/downloads/Klaus%20Vogel\\_2001.pdf](http://www.fitindia.org/downloads/Klaus%20Vogel_2001.pdf) [15  
July 2012].
57. Kusters, B. 2004. The United Nations Model Tax Convention and Its Recent  
Developments [Online].  
Available:[http://unpan1.un.org/intradoc/groups/public/documents/unpan/unpan01487](http://unpan1.un.org/intradoc/groups/public/documents/unpan/unpan014878.pdf)  
[8.pdf](http://unpan1.un.org/intradoc/groups/public/documents/unpan/unpan014878.pdf) [17 May 2012].
58. Legal Information Institute. 2012. <http://www.law.cornell.edu/uscode/text/26/674> and  
<http://www.law.cornell.edu/supremecourt/text/200/118>. [Online]. Available: [20 May  
2012].
59. Legislation.gov.uk. 2012. [Online]. Available  
<http://www.legislation.gov.uk/ukpga/2007/3/notes/division/2/7/1/4/1/2> [20 May  
2012].
60. Loan Markets Association. 2011. [Online]. Available:  
<http://www.oecd.org/tax/taxtreaties/48415402.pdf> [30 May 2012].
61. Novexcen.com. Cases and Court Decisions. [Online]. Available:  
[http://www.novexcen.com/cases\\_court\\_decisions\\_main.html](http://www.novexcen.com/cases_court_decisions_main.html). [15 July 2012].
62. OECD. 2012. <http://www.oecd.org/>
63. SAICA. 2011. Integritax. Meaning of Beneficial Owner. [Online]. Available:  
[http://www.saica.co.za/integritax/2011/1992.\\_Meaning\\_of\\_beneficial\\_owner.htm](http://www.saica.co.za/integritax/2011/1992._Meaning_of_beneficial_owner.htm) [17  
May 2012].
64. SARS. 2012. <http://www.sars.gov.za/>

65. Tax Bulletin. 2008. Beneficial Ownership by Holding Company Respected. [Online]. Available:  
<http://www.airdberlis.com/Templates/Newsletters/newsletterFiles/86/Tax%20Bulletin%20-%20Prevost.pdf> [20 May 2012].
66. The Civil Code Reloaded (Russian). 2012. [Online]. Available:  
[http://www.cliffordchance.com/publicationviews/publications/2012/04/the\\_civil\\_code\\_reloadedrussian.html](http://www.cliffordchance.com/publicationviews/publications/2012/04/the_civil_code_reloadedrussian.html) [15 July 2012].
67. TKZ Attorneys. 2012. Russia to target treaty shopping and payments to blacklisted jurisdictions. [Online]. Available. <http://www.tkzattorneys.eu/2012/05/14/russia-to-target-treaty-shopping-and-payments-to-blacklisted-jurisdictions/> [20 May 2012].
68. UN. 2012. <http://www.un.org/>
69. Vakil No 1. 2012. [Online]. Available:  
<http://www.vakilno1.com/bareacts/incometaxact/s45.htm>. [20 May 2012].
70. Wang, A, 2012. New Circular Clarifies Definition of “Beneficial Owner” in China Tax Treaties. [Online]. Available:<http://www.hg.org/article.asp?id=18262> [15 July 2012].